

GAO

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**Report to the Chairman, Committee on
Foreign Relations, U.S. Senate**

July 1989

CENTRAL AMERICA

Impact of U.S. Assistance in the 1980s





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National Security and
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The Honorable Claiborne Pell
Chairman, Committee on Foreign Relations
United States Senate

Dear Mr. Chairman:

To respond to your request and to assist the administration and the Congress in the decisions they face in Central America, we reviewed U.S. assistance to the five Central American countries, Panama, and Belize since 1980.

The report focuses on the impact of U.S. programs and activities that sought to promote four major U.S. policy objectives, namely regional security, democracy, economic stabilization and structural adjustment, and development. The report also proposes matters for consideration by the administration and the Congress in developing future U.S. strategies for the region.

We are sending copies of this report to the Office of Management and Budget; the Departments of State, Defense, Justice, and Treasury; the Agency for International Development; the Peace Corps; and other congressional committees. We will furnish copies to others on request.

This report was prepared under the direction of Nancy R. Kingsbury, Director, Foreign Economic Assistance Issues, and Joseph E. Kelley, Director, Security and International Relations Issues. Other major contributors are listed in appendix V.

Sincerely yours,

Frank C. Conahan
Assistant Comptroller General

Executive Summary

Purpose

To assist the administration and the Congress in the decisions they face regarding Central America, GAO reviewed the impact of U.S. programs and activities in the five Central American countries, Panama, and Belize during the 1980s. These programs and activities focused on four major U.S. policy objectives:

- promoting regional security,
- strengthening democracy,
- achieving economic stabilization and structural adjustment, and
- advancing equitable broad-based development.

GAO visited all seven countries and obtained perspectives from Central American and U.S. experts on the region at GAO-sponsored conferences in San Jose, Costa Rica, and Washington, D.C.

Background

Key events of the late 1970s and early 1980s, including (1) the signing of the Panama Canal Treaty, (2) the rise of the Marxist Sandinista government in Nicaragua, and (3) the growth of leftist insurgency in El Salvador, led to an increased U.S. focus on Central America. In response to concerns about U.S. and Central American security, the United States increased military aid to El Salvador and Honduras and in 1981 began supporting the Nicaraguan Democratic Resistance (contras) in its opposition to the Nicaraguan government.

The National Bipartisan Commission concluded in a 1984 report on Central America that foreign-supported elements were using the region's widespread poverty and social injustice to gain popular support against the region's governments. It recommended that the United States (1) counter the foreign-supported elements fostering regional instability and (2) promote democracy through programs to achieve economic growth and development. In response, the Congress increased military aid to El Salvador and Honduras and approved a 5-year economic aid program for the region.

In the ensuing years, the United States continued to fund military and economic assistance to the region, maintained a military presence in Honduras to support U.S. military exercises and signal U.S. resolve to support its allies from the Cuban/Nicaraguan threat, financially supported the contras, and continued diplomatic efforts to promote peace and democracy in the region. Simultaneously, Mexico, Venezuela, Colombia, and Panama persevered in their Contadora initiative begun in 1983, which sought to resolve the conflicts in Central America and alleviate

the tension between the United States and Nicaragua. Through 1987 several drafts of an agreement were circulated for approval, but all proved unacceptable to either the United States, Nicaragua or other Central American nations. In August 1987 the five Central American countries demonstrated their desire to take control of the peace process by signing the Esquipulas II peace accord. The accord called on all governments to enact cease-fires and offer amnesty to internal opposition groups, promote democratic reforms, cease all aid to insurgents, and deny the use of their territories to elements seeking to destabilize Central American governments.

By 1989 it was apparent that the peace plan had not resulted in the changes anticipated and that compliance varied by country. Nevertheless, in February of this year, the Central American presidents renewed their attempts to find a regional solution to the region's problems. The presidents took note of Nicaragua's democratization plans and agreed to develop a plan for repatriating or resettling the contras, currently being maintained inside Honduras with U.S. humanitarian aid. Subsequently, the administration and congressional leadership agreed to pursue a bipartisan policy of maintaining the contras in Honduras with U.S. humanitarian aid until Nicaragua follows through on its pledge to hold free elections in February 1990.

Results in Brief

Although progress was made in achieving each of the four U.S. objectives, less was accomplished than anticipated because regional conflicts were not ended and economies did not rebound as envisioned, and the time frames established were proven to be unrealistic. Moreover, some countries could not quickly overcome a long history of military dictatorships, inefficient and corrupt government institutions, extreme poverty, and political violence.

The United States, of course, cannot unilaterally remove the obstacles to peace and development in Central America. The region's development will require a long-term U.S. financial commitment, greater support from the international community, and a greater commitment by the Central American countries themselves.

Our analysis strongly suggests that the United States should support Central American initiatives such as the revived Esquipulas II regional peace plan. This plan provides a framework for Central Americans to address current conflicts. The United States can support this effort by using this framework to address the major foreign policy issues it faces

in the region. The current administration has demonstrated a greater willingness to move in that direction, even if the recent bipartisan Central American agreement does not call for the immediate repatriation of the contras.

Principal Findings

Regional Security Remains in Upheaval

Achievement of the first U.S. objective of advancing regional security remains crucial to the success of the other three U.S. objectives of promoting democracy, economic stabilization and structural adjustment, and broad-based development. While, U.S. regional security policies may have halted further Soviet expansion in Central America, peace and stability have not yet been achieved. High levels of U.S. aid prevented the likely victory by insurgents in El Salvador; however, that insurgency and the one in Guatemala continue. Efforts to professionalize and modernize military forces have been hampered by institutional weaknesses. Some concerns exist about the susceptibility of weak civilian governments to military influence; however, at this time, the militaries in El Salvador, Honduras, and Guatemala support their elected governments. Despite U.S. pressure, Nicaragua's Sandinista government and Panama's General Noriega rule without making major concessions to democracy. Although the United States publicly supported peace efforts of the Contadora Group and the Central American countries, at times U.S. policy has had the effect of undermining the intent of these agreements.

Major security problems remain in Central America and Panama. In El Salvador, extensive military aid will be required to continue the government's war against its insurgency, and only limited progress toward U.S. economic, development, and democracy objectives can be expected until the war ends. Nicaragua continues to pose security problems for the rest of the region due to its past military buildup and support for insurgencies. The debate continues over whether or not to allow Guatemala to purchase lethal equipment with U.S. military aid. Finally, the continuing crisis in Panama has raised concerns about U.S.-Panamanian relations, the safety of U.S. personnel, and the security and operations of the Canal after 1999.

Fragile Democracies Face Major Challenges

The precise impact of U.S. programs and policies on the second objective to promote the region's movement toward democracy is difficult to measure. Economic support and development assistance helped maintain the relatively stable democracies of Costa Rica and Belize and supported the democratic transitions in El Salvador, Guatemala, and Honduras. Although the overall human rights situation in Central America improved, consistent respect for human rights has not been achieved. Progress toward judicial reform was made, but serious deficiencies could not be overcome in the short term. Continuing violence, inequitable socioeconomic conditions, drug trafficking, corruption, and other conditions pose significant challenges to the fragile democracies that have evolved. These conditions could negatively affect democratic transitions throughout the region unless democratic institutions and processes are further strengthened.

Uneven Success in Meeting the Economic Objectives

The success of U.S. efforts to achieve the third objective of economic stabilization and structural adjustment varied by country. High levels of U.S. aid helped to halt economic decline in El Salvador, Honduras, Belize, Costa Rica, and Guatemala, but each country remains dependent on external assistance. U.S. economic stabilization and adjustment efforts were more successful in Costa Rica, Belize, and Guatemala because these countries were committed to reforms that had popular support. Still, Costa Rica must deal with a burdensome debt problem, Belize has an inadequate economic base, and Guatemala has far-ranging development needs. Progress in El Salvador was hampered by U.S. and Salvadoran unwillingness to risk political instability arising from major economic reforms, and extensive damage caused by the guerrillas and the 1986 earthquake. Honduras did not accept the need for reforms, viewed U.S. aid as a substitute for reforms, and was able to resist implementing economic reforms the United States sought because the Honduran government supported U.S. regional security programs. However, Honduras has recently been more amenable to reforms being suggested by the United States. U.S. sanctions on Panama and Nicaragua contributed to already serious economic problems brought on by their political situations.

Obstacles Facing Broad-Based Development Goals

While U.S. aid has helped Central American countries maintain higher living standards than otherwise would have been possible, the fourth objective of broad-based development was not attained to the extent anticipated. With the exception of Costa Rica, Central American countries remain constrained in their ability to provide social services to and

generate jobs for the poor. Poverty and economic inequities continue, in some countries at levels worse than a decade ago. Development progress has been hampered by slowed economic growth, armed conflicts, weak host government capabilities and their failure to implement needed policy and institutional reforms, natural disasters, a poor investment climate, and administrative requirements of U.S. aid programs.

Matters for Congressional Consideration

Regional Security

GAO's analysis suggests that, to further promote regional security, the United States should support the regional peace plan by discussing with the Central American presidents the U.S. role in (1) promoting a regional solution on the future of the contras, (2) monitoring and verifying compliance with the plan's provisions, and (3) formulating penalties for non-compliance and incentives for compliance.

Strengthening Democracy

GAO's analysis suggests that, to support Central America's movement toward democracy, the United States should (1) support Central American initiatives and multilateral approaches when possible to lower the U.S. profile in sensitive areas and reinforce societal elements working toward democratic changes, (2) continue support for judicial reform and the selective use of conditionality to urge governments to improve their performance in the human rights area, and (3) intensify programs to strengthen both civilian and military institutions with the aim of increasing accountability and reducing the corruption and inefficiency that undermine public confidence in democratic governments.

Economic Stabilization

GAO's analysis suggests that, to further U.S. economic goals, the United States should (1) assist Costa Rica in dealing with its serious commercial debt problem; (2) continue assistance to Belize; (3) encourage Guatemala to privatize inefficient government-owned enterprises; and (4) recognize that due to the political and security situation in El Salvador and the absence of economic reforms in Honduras, additional and prolonged assistance will be necessary.

Broad-Based Development

While greater progress is needed in attaining broad-based development, any U.S. effort to accelerate progress would be undermined by the continuing regional conflicts and economic difficulties. GAO's analysis suggests that if substantial progress is made in resolving these problems, the United States should consider shifting some Economic Support Funds to projects promoting broad-based development. The United States should also consider conditioning aid on institutional and policy reforms needed to improve social services and strengthening efforts to create jobs and income by (1) promoting microenterprise development; (2) supporting efforts to redistribute land, provide credit, and extend technical assistance to small farmers; and (3) promoting investment by encouraging reform needed to improve the investment climate and continuing favored access to the U.S. market.

Agency Comments

The Department of Defense did not provide official comments on a draft of this report. However, GAO officials discussed the draft with responsible Defense Department officials and incorporated their points where appropriate. Both the Department of State and the Agency for International Development supplied official comments.

Overall, State disagreed with GAO's assessment of the impact of U.S. policy and some programs and the reasons as to why peace has not been achieved. The Department felt that in fairness GAO should have recognized the open-ended nature of U.S. efforts to pursue its goals and should not have evaluated these efforts based on unrealistic time frames. GAO agrees with the Department and points out that U.S. objectives must be considered long term and that time frames that the executive branch had established were unrealistic. Further, State commented that the report implies that the United States cannot have interests separate from Central Americans, cannot act on its own to meet those interests, and inaccurately describes why peace has not been achieved. The report has been clarified to reflect agreement that the United States must maintain the right and flexibility to determine its interests and actions. In the report GAO points out that Nicaragua has contributed to regional instability but also observes that social, political, and economic conditions that caused the rise of discontent in Central American countries are similarly important in explaining the absence of peace.

The Agency for International Development generally agreed with our observations on development-related issues and our analyses of U.S. stabilization and adjustment efforts. It had some minor points of clarification and/or disagreement, and GAO clarified the report to accommodate these observations where appropriate. Agency comments and GAO responses are included in appendix IV.

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Abbreviations

AID	Agency for International Development
CAPEL	Center for Electoral Assistance and Promotion
CAI	Central American Initiative
CIA	Central Intelligence Agency
ESF	Economic Support Funds
FMLN	Farabundo Marti Liberacion Nacional
FMS	Foreign Military Sales
GAO	General Accounting Office
GDP	Gross Domestic Product
IIHR	Inter-American Institute of Human Rights
ILANUD	Institute for the Prevention of Crime and Treatment of Offenders
IMET	International Military Education and Training
IMF	International Monetary Fund
MAP	Military Assistance Program
PDF	Panama Defense Forces

Introduction

Central America's recent political and socioeconomic difficulties have resulted from a combination of internal and external circumstances. Problems arising from a history of violence, oppression, poverty, and social injustice were compounded by the world oil crises of 1973-74 and 1978-80 and subsequent international economic recessions. As these problems intensified and the Soviet Union, Cuba, and Nicaragua began to pose a security threat to the region and the United States, the administration and Congress began focusing more attention on Central America.

Background

Several key events of the late 1970s and early 1980s heightened U.S. interest in Central America. The United States and Panama signed the Panama Canal Treaties of 1977, which obligated the United States to give control of the Canal to Panama by the year 2000. The Somoza government in Nicaragua was overthrown by the Sandinistas in 1979, and, along with Cuba, the Sandinistas began supporting Marxist-led insurgents threatening to topple the government of El Salvador. The region's economic deterioration, heightened poverty, and sociopolitical unrest were also increasing the number of immigrants illegally entering the United States.

Marxist activity in the region raised the specter of eventual external threats to U.S. security. To counter the threat posed by Salvadoran insurgents, the United States provided El Salvador \$6 million in military aid in 1980 and \$35 million in 1981. To counter Sandinista subversion, the United States supported the Democratic National Resistance (contras) to oppose Nicaragua's government, established a U.S. military presence in Honduras, began an extensive program of training exercises with the Honduran military, and increased its intelligence activities in the region. U.S. assistance, conditioned on observance of human rights, was rejected by the military government of Guatemala.

In 1983 the President created a National Bipartisan Commission on Central America, chaired by former Secretary of State Henry Kissinger, to recommend appropriate U.S. responses to the problems in Central America. The Commission's January 1984 report concluded that the United States could best serve its strategic interests in Central America by pursuing a policy that promoted long-term stability. It recommended that the United States (1) assist the Central American countries in countering the foreign-supported elements that fostered regional instability and (2) simultaneously initiate a 5-year, \$24 billion assistance effort to promote democracy through economic growth and development and

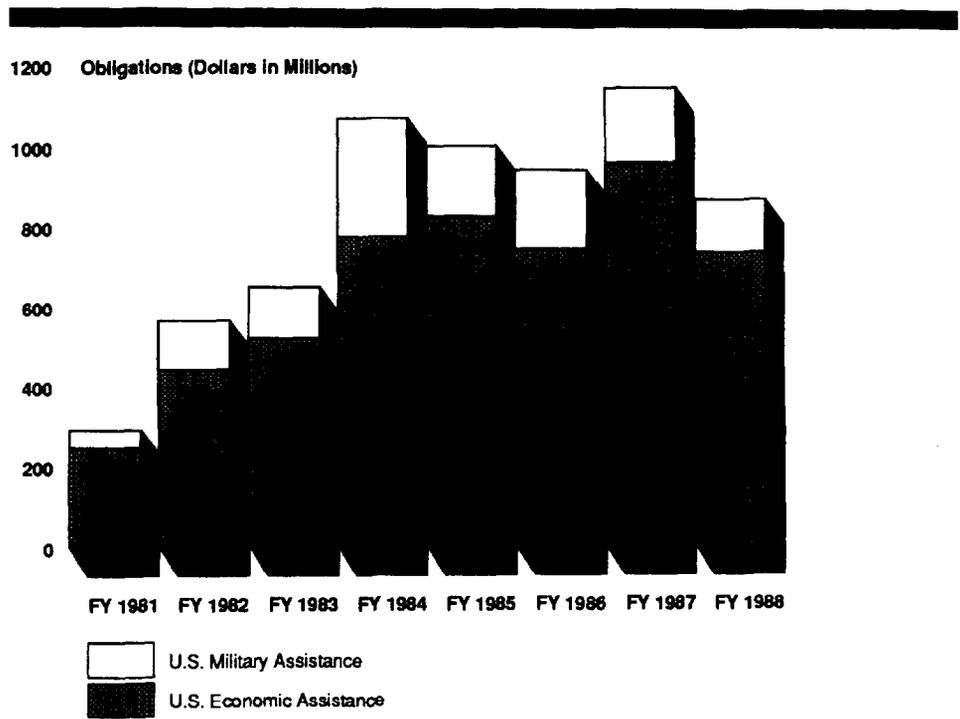
through support of democratic institutions.¹ The Commission projected that the United States would provide \$12 billion in assistance and that international financial institutions, other bilateral donors, private investors, and commercial banks would provide the remaining \$12 billion. The Commission's projections on external assistance to the region were based on the assumptions that (1) the insurgencies in El Salvador and Nicaragua and the political conflict between Nicaragua and its neighbors would be eliminated in less than 2 years and (2) the Central American countries would follow prudent economic policies and achieve steady political and social progress. These assumptions and the time frames were ultimately proven unrealistic.

Congress passed an emergency aid package for fiscal year 1984, and in February 1984 the administration submitted the Central American Democracy, Peace, and Development Initiative to the Congress. The initiative, designed to pursue the recommendations of the Kissinger Commission, recommended a 5-year, \$8.4 billion package of economic assistance programs to cover fiscal years 1985 through 1989, including \$6.4 billion in funding and \$2 billion in guarantees, and proposed substantial, but unspecified, increases in U.S. military assistance. Subsequently, an administration review recommended extending the initiative through fiscal year 1992 with total funding of about \$6.9 billion. The assistance package focused on improving conditions in Costa Rica, El Salvador, Guatemala, Honduras, and to a lesser extent Belize.

As shown in figures 1.1 and 1.2, the United States provided more than \$6.5 billion in military and economic assistance to Central America during fiscal years 1981-88. During this period, U.S. military assistance to the region increased from \$44.8 million in fiscal year 1981 to a high of \$297.2 million in fiscal year 1984 before gradually declining to about \$132 million during fiscal year 1988. U.S. economic assistance, including Economic Support Funds (ESF), Development Assistance, food assistance provided under Public Law 480, and Peace Corps activities, also dramatically increased from \$247.3 million in fiscal year 1981 to a high of \$957.2 million in fiscal year 1987 before falling to about \$730.0 million in fiscal year 1988. El Salvador was the largest aid recipient during this 8-year period, receiving a little more than \$3 billion, approximately \$2.2 billion of which was economic assistance. In addition, the United States provided \$1.4 billion to Honduras, \$1.1 billion to Costa Rica, \$620.4 million to Guatemala, and \$85.6 million to Belize.

¹The recommended \$24 billion did not include Belize, which is generally considered to be part of the Caribbean rather than Central America.

Figure 1.1: U.S. Economic and Military Assistance to Central America for Fiscal Years 1981-88



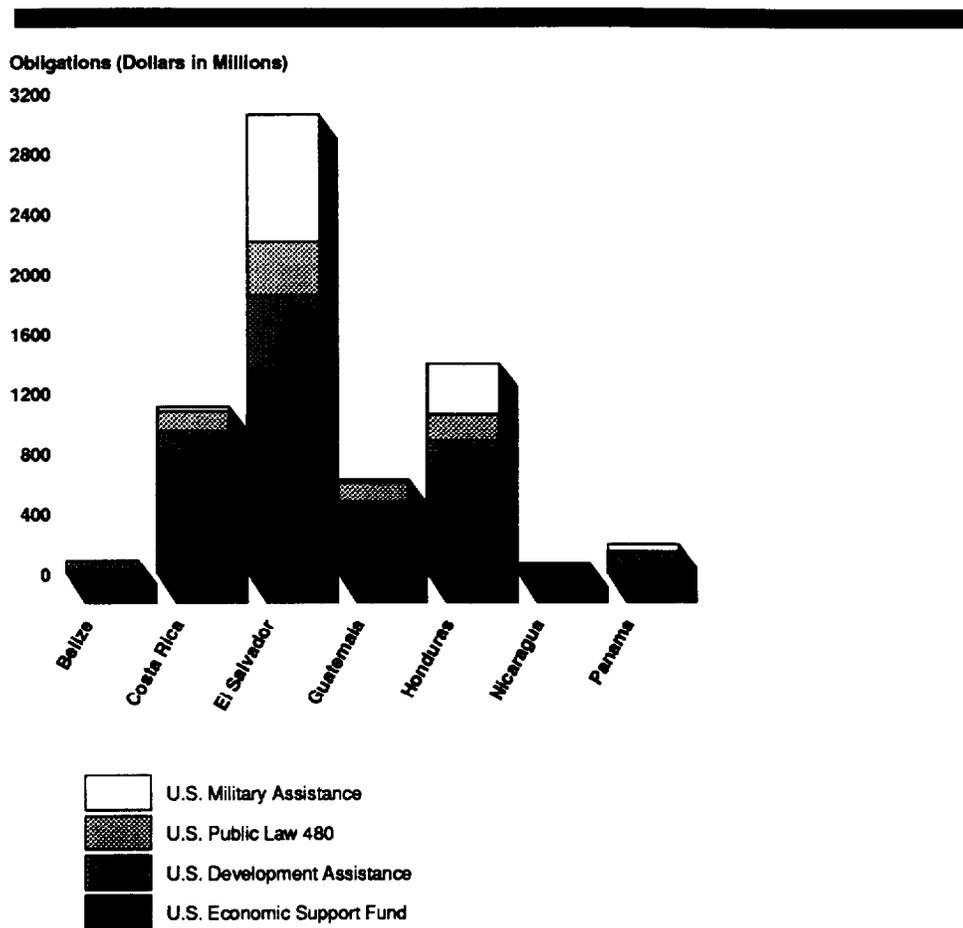
U.S. Economic Assistance includes ESF/DA/PL480

U.S. Development Assistance includes Peace Corps and International Narcotics Control data

FY 1988 Peace Corps data is estimated

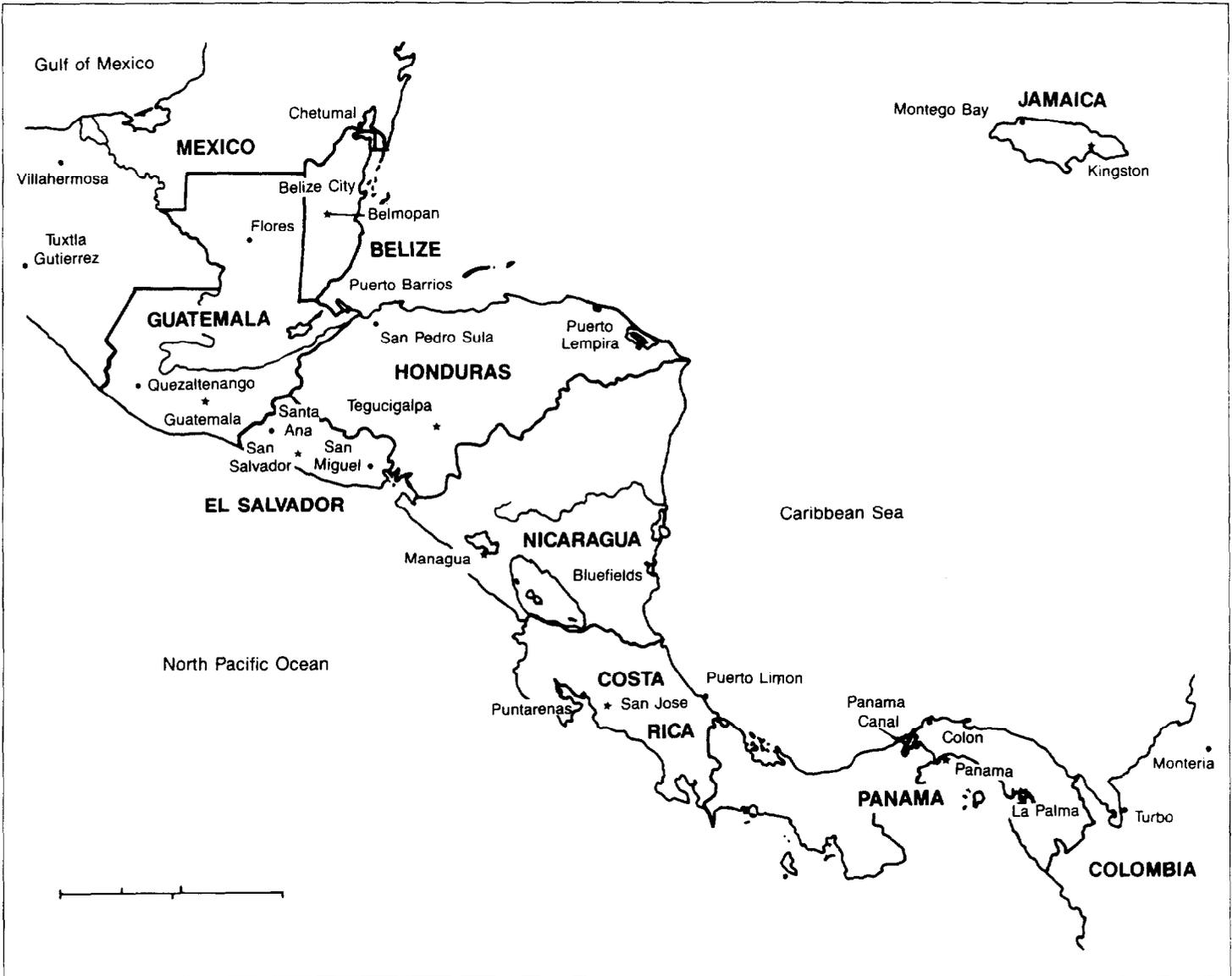
U.S. Military Assistance includes MAP/IMET/FMS

Figure 1.2: Assistance to Central America by Country, Fiscal Years 1981-88



U.S. Development Assistance includes Peace Corps and International Narcotics Control data

Figure 1.3: Map of Central America



Objectives, Scope, and Methodology

To respond to the request of the Chairman, Senate Committee on Foreign Relations, and to assist the new administration and the Congress in addressing future decisions, we reviewed the impact and effectiveness of U.S. programs and activities implemented in Central America during the 1980s. For purposes of this review, we defined Central America to

include the five countries that traditionally comprise the region—Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua—as well as Belize and Panama. We examined U.S. programs and activities that sought to attain four major U.S. policy objectives: (1) promoting regional security, (2) achieving economic stabilization and structural adjustment, (3) advancing equitable broad-based development, and (4) strengthening democracy.

In evaluating the impact of U.S. programs and strategies in the region, we

- interviewed U.S. government officials and representatives of private sector organizations and multilateral institutions in the United States;
- conducted an extensive review of literature, including U.S. government, host-country government, and international organization reports and studies;
- sponsored a symposium in San Jose, Costa Rica, to obtain the perspectives of experts from Central America regarding U.S. programs and activities in the region;
- interviewed U.S. government and host-country government officials and representatives of private voluntary organizations, multilateral organizations, political parties, and the private sector in all seven countries; and
- conducted a conference on Central America and a workshop on Panama in Washington, D.C., during which U.S. government and nongovernment experts discussed our tentative review findings and shared their views concerning the future direction of U.S. policies in the region.

We have included in-depth analyses of Central America in the report. While reference to Panama is made in the report, our review of this country continues.

Our fieldwork was conducted during the same period as a related Congressional Research Service study on Central America.² We coordinated our efforts with the Service, both in the field and in Washington.

Representatives of the Departments of State and Defense and the Agency for International Development (AID) informally commented on a series of internal GAO discussion papers as our review progressed and participated in our Washington conference on Central America. State and AID representatives also participated in the workshop on Panama.

²Forum: Central American Dilemmas and U.S. Policy, Congressional Research Service, February 1989.

Impact of U.S. Assistance in Advancing Regional Security

The rise of insurgencies and the increasing overall threat of Soviet-Cuban-Nicaraguan expansion in Central America have presented serious challenges to U.S. and Central American security during the 1980s. Central America is strategically vital to the United States. U.S. foreign trade and petroleum pass through the Panama Canal and the Caribbean, and about half of all sea cargo would pass through the region to supply North Atlantic Treaty Organization allies in a crisis. The Kissinger Commission, in recommending its plan for addressing the internal and external threats to regional security suggested that "the United States faces serious strategic implications due to Soviet-Cuban support for armed insurgency in the region." The Commission warned that consolidation of a Marxist-Leninist regime in Nicaragua would create a permanent security threat to the region. The concerns of the Commission and others that "communist-led" terrorism, influence, and destabilizing actions were occurring in Central America and reports of a major military buildup by the Sandinistas resulted in a substantial commitment of U.S. military aid and support to the region to protect the security of the United States and its Central American allies.

Through this commitment, the United States has made some progress in advancing regional security, and U.S. programs have had some positive impacts in Central America in the 1980s. U.S. aid prevented the takeover of the Salvadoran government by leftist insurgents, enhanced Central American militaries' capabilities, and may have halted further Soviet expansion in the region. However, regional conflicts have not ended, as assumed by the Kissinger Commission, in part, according to the Department of Defense (DOD), because they received 22 percent less in military assistance than requested. The Sandinista government of Nicaragua has consolidated its power and remains a security concern to its neighbors. The U.S.-supported contras, once seen as an answer to the Nicaraguan problem, are now perceived by Honduras as a potential threat to its political, economic, and social well-being. The Salvadoran insurgency has been greatly reduced but remains a continuing threat to El Salvador's security and stability. Guatemala has also reduced the number of insurgents but has not been able to end the insurgency. Further, some countries have had difficulty overcoming a legacy of military dictatorships, inefficient and corrupt government institutions, extreme poverty, and political violence.

There are limits to what the United States can do to alter events in the region. Recent events, including a renewed emphasis on the Central American peace plan and a willingness on the part of the governments of El Salvador and Nicaragua to discuss or propose solutions to the

region's conflicts, may eventually restore peace to the region. If so, the U.S. role in assisting Central America may be different in the future.

U.S. And Central American Approaches to Regional Security

According to the Department of State, the United States established security objectives in Central America to protect the United States and the Central American region from potential Soviet, Cuban, and Nicaraguan aggression and the exportation of insurgency and to promote peace and democracy in the region. In 1984 the administration reported that "the export of violence by Cuba and Nicaragua with Soviet backing is the principal external security threat to democracy in the hemisphere" and noted that the United States was working to contain "Nicaragua's military ties to Cuba and the Soviet bloc, its subversive activities, militarization, and internal repression." According to U.S. government officials, the Nicaraguan government, supported by Cuba and the Soviet bloc, was trafficking arms to El Salvador's Farabundo Marti Liberacion Nacional (FMLN) insurgents. Further, the Nicaraguan military was undergoing an unprecedented military buildup and acquiring large amounts of military equipment and armaments from the Soviet bloc. Moreover, both the Soviet Union and Cuba were providing military advisers, thus giving Nicaragua a considerable military advantage over the other countries in Central America.

U.S. interests and security objectives were also reflected in the Kissinger Commission report. The Reagan administration requested that the Kissinger Commission study the situation and recommend alternatives for dealing with the region's political, social, economic, and security issues. The administration adopted the Commission's recommendations, including the recommendation to focus U.S. aid on security goals in order to restore peace and stability to the region. The Commission's report stated that the general strategic objective of U.S. diplomacy in Central America should be to remove the civil wars and national conflicts from the global East-West context to their more appropriate level of regional or internal strifes. Specifically, the Commission recommended that the United States provide significantly increased levels of military aid to El Salvador in the short term to help end the war, provide increased military assistance to Honduras to build a credible and deterrent force against Nicaragua, provide assistance to Guatemala to aid it in pursuing a more consistent and humane counterinsurgency strategy, assist Nicaragua in becoming a peaceful and democratic neighbor, and promote democracy and development in all the Central American countries. Because of the Commission's recommendation to increase military aid to the region, particularly to enable El Salvador to defeat the FMLN insurgent forces,

Congress met the administration's fiscal year 1984 supplemental aid request of \$553.7 million, of which \$195.2 million was military aid.

In addition to providing military support to the Salvadoran government in its armed conflict, in 1981 the United States authorized covert paramilitary actions against the Sandinista government in Nicaragua by funding the contras. Congressional debate followed about these covert activities and, in 1982, Congress passed the Boland Amendment to ensure that monies appropriated for the contras would not be used to overthrow the government of Nicaragua. Reports of increased covert and illegal actions and mining operations resulted in the passage of an amendment in 1984 to prevent any further direct support of the contras. The President signed legislation authorizing \$27 million in humanitarian aid for the contras. Thereafter, in October 1986, Congress approved the administration's request for \$100 million in lethal and nonlethal aid to the contras, and in 1988 Congress appropriated a total of \$45 million in humanitarian assistance to the contras and victims of the Nicaraguan conflict. Funding for the contras has been one of the most controversial foreign policy issues of the 1980s. In March 1989, the administration announced that it had reached a bipartisan accord with the congressional leadership to foster peace while continuing nonlethal aid to sustain and/or relocate the contras. The bipartisan agreement provides for \$49.75 million through February 1990, by which time the Sandinistas have pledged to hold free elections.

To achieve its security objectives in Central America, the United States not only provided increased levels of security assistance to the region and funded the contras in their armed conflict against the Sandinista government but also enhanced intelligence activities; expanded U.S. military exercises, most notably in Honduras; funded humanitarian and civic action activities; imposed conditions on U.S. aid to El Salvador and Guatemala based on democratic reforms and increased respect for human rights; and applied economic sanctions to Nicaragua. Security assistance to the region peaked during fiscal year 1984, particularly to El Salvador and Honduras, and declined during the latter part of the 1980s, with El Salvador and Honduras continuing to receive the highest amounts of U.S. military aid.

Efforts to Promote Peace Through Dialogue

As part of the strategy to bring peace and security to the region, U.S. officials engaged in bilateral talks with all nations, including Nicaragua, and publicly supported Central American peace efforts such as Esquipulas II. During bilateral talks with Nicaragua, the United States raised its

security concerns, including (1) an end to Nicaraguan support of insurgencies, (2) a reduction in the size of the Nicaraguan military, (3) the removal of Soviet and Cuban influence, and (4) the development of political and democratic pluralism. The Nicaraguan position called for (1) an end to U.S. support for the contras, (2) a reduction in the U.S. military presence in Honduras and El Salvador, (3) an end to military exercises near Nicaragua's borders, and (4) respect for Nicaraguan sovereignty. In other efforts to promote peace, Secretary of State Shultz met with Central American leaders and dispatched special U.S. envoys on several occasions to convince them to support U.S. policies and isolate Nicaragua. The situation, however, remained unresolved.

The Contadora initiative, which began in 1983, was an effort by the foreign ministers of Mexico, Venezuela, Colombia, and Panama to consider means to resolve conflicts in Central America and alleviate the tension between the United States and Nicaragua. Together with the Central American countries, the Contadora group set out to negotiate a comprehensive agreement on Central American political, economic, and security issues. Some members of Congress endorsed the agreement as a peaceful, multilateral alternative to what, in their opinion, had been a confrontational approach toward Nicaragua. The administration and other members of Congress declared their support for the initiative but continued to back military efforts as necessary to strengthen negotiations and protect the region's security. Through 1987, several drafts of the Contadora Agreement were circulated for approval, but all proved unacceptable to either the United States, Nicaragua, or the other Central American nations. The Reagan administration voiced its support for the plan but expressed its concern over implementation of specific aspects of the initiative and the absence of enforcement mechanisms. Also missing from the proposal was a requirement that Nicaragua end its alignment with the Soviet bloc and Cuba.

Central American experts raised concerns about U.S. attempts to dominate events in Central America, the stalemate between the United States and Nicaragua, and the U.S. contra policy. However, many Central Americans also shared U.S. concerns about regional security and the verification of Nicaragua's compliance with the peace agreement. On August 7, 1987, the Central American presidents demonstrated their desire to take control of the peace process by signing the Esquipulas II peace accord in Guatemala. The plan represented a compromise among the five Central American countries. While its provisions applied to all the countries, it provided a basis to come to terms with the situation in Nicaragua. The accord calls on governments to (1) enact cease-fires and

offer amnesty and dialogue to internal opposition groups, (2) promote implementation of democracy, (3) cease military and other aid to insurgents, and (4) deny use of their territories to elements seeking to destabilize Central American governments.

After nearly 18 months, the peace plan had not resulted in the major changes anticipated, and compliance with the plan's provisions varied from country to country. For example, Nicaragua continued to resist pressure to democratize citing U.S. aid to the contras as the cause, and the staging of the contras in Honduras placed Honduras in a noncompliance position. Nevertheless, the Central American presidents renewed their commitment to the plan in February 1989 meetings in El Salvador. At those meetings, the presidents took note of Nicaragua's recent plans for promoting democracy and agreed to prepare a plan on how to repatriate or relocate the contras, who are currently in camps within Honduras. The presidents also discussed the proposed multilateral verification efforts to ensure compliance with the plan's security and democracy-related provisions. These proposals call for (1) the United Nations to monitor and verify security provisions in each country and assist in the repatriation or resettlement of refugees and the contras and (2) an international team to observe elections in Nicaragua in February 1990.

Central American Countries Still Face Security Problems

After providing extensive U.S. military assistance, regional security remains a major problem of the United States and its Central American allies. Overall, the success of U.S. programs and activities varied significantly from country to country. U.S. aid prevented the likely victory by insurgents in El Salvador; however, that insurgency continues, as does the one in Guatemala, where the United States has not provided funds for the purchase of lethal weapons or ammunition since fiscal year 1986. U.S., Honduran, Salvadoran, and Costa Rican government officials still view Nicaragua as a threat to the stability of the region.

Overall, U.S. government officials cited inconsistent, lower-than-requested funding levels and host government institutional problems as the primary reasons that U.S. security objectives have not been fully attained. In addition to these factors, some U.S. security objectives may not have been fully attained because they were implemented at cross-purposes with other U.S. objectives and without full consideration of their possible consequences. For example, some U.S. actions may have contributed to increasing the number of refugees and the plight of the middle class, increasing Central American dependency on the United States, and alienating traditional U.S. supporters. Inconsistent funding

of the contras, unilateral imposition of economic sanctions on Nicaragua, and a conditional commitment to the Central American peace plan frustrated some Central Americans. The increased funding during the 1980s raised the dependency of Central American militaries—particularly those of El Salvador and Honduras—on the United States for their sustenance and support even though these increasing levels of assistance and military equipment might have been necessary to achieve security goals. In sum, U.S. projections on what the aid could achieve, specifically in putting down insurgencies, proved to be unrealistic.

El Salvador Struggles to End Conflict

From fiscal years 1981 to 1988, the United States provided El Salvador with nearly \$825 million in Military Assistance Program (MAP) and Foreign Military Sales (FMS) credits funds and prevented the insurgents from overthrowing the Salvadoran government. The program expanded inventories of defense equipment and improved firepower, mobility, and command, control, and communications. In addition, up to 55 U.S. military trainers are assigned to Salvadoran military commands to provide training. These trainers, along with technical assistance provided under MAP and the International Military Education and Training (IMET) program, have helped the Salvadoran military increase its professional and technical skills and have assisted the Salvadoran army in taking the offensive against the insurgents. U.S. efforts to promote respect for human rights and condition aid accordingly have helped reduce the number of reported human rights abuses from the number reported in the early 1980s, although such abuses continue to occur.

In analyses throughout this period, the administration was fairly optimistic about ending the conflict with the higher levels of assistance that it requested and ultimately obtained. U.S. and Salvadoran military officials now agree that the insurgency will not be entirely eliminated until the causative social, political, and economic injustices are eradicated. They define “winning” as containing the insurgency sufficiently to allow some economic and democratic progress to occur. Under this scenario, high levels of both U.S. military and economic aid to El Salvador will be required over the long term just to maintain the status quo. U.S. military officials agree that, without a political solution, the war could continue for years and that the Salvadoran military will require \$100 million annually (in current U.S. dollars) for sustenance only. In addition, significant amounts of economic assistance will have to continue simply to repair damaged infrastructure and maintain the economy and standard of living at passable levels. As a result, the United

States would have to scale down projections of what its economic aid could reasonably achieve under war conditions.

The United States can strengthen its efforts in El Salvador by (1) encouraging government-insurgent negotiations toward a settlement and (2) conditioning U.S. assistance on government actions to reduce human rights abuses and continue democratic reforms. While peace would create an environment for progress toward meeting El Salvador's socioeconomic needs, it still would not guarantee success. Serious economic and social problems will remain, requiring a high degree of long-term external support. Reconstruction needs, pervasive poverty, a high population growth rate, the weaknesses of civilian institutions compared with the strength of the military, and extreme political polarization that grew out of the conflict are only a few of the problems. Reducing the size of the 54,000-member military to its pre-buildup level of approximately 15,000 would create a major unemployment problem. In the absence of high levels of foreign assistance to deal with these problems, these conditions most likely would lead to further social unrest and potentially the reemergence of the insurgency.

U.S. Relations With Nicaragua and the Contras

Bilateral relations between the United States and Nicaragua have been severely strained due to Nicaragua's failure to comply with the promises it made in 1979, the subsequent cutoff of U.S. economic aid, and the arming of the contras in response to intelligence reports that the Sandinistas were actively supporting the insurgents in El Salvador. According to the Department of Defense, Soviet bloc deliveries of military supplies to Nicaragua were valued at \$3.2 billion during the 1980-88 time period. Further, Soviet economic assistance, totaling about \$475 million, continued in 1988.

Stated U.S. objectives towards Nicaragua have not been entirely clear or consistent. Depending upon the timing or the source, U.S. objectives have ranged from containing Nicaragua's Marxist-Leninist government to destabilizing it to democratizing it. Economic sanctions imposed in 1985 to pressure Nicaragua to democratize further inflamed relations as the Sandinista government accused the United States of meddling in its internal affairs and seeking its overthrow. U.S. economic sanctions against Nicaragua contributed to further impoverishment of its population without resulting in changes in its undemocratic regime.

Over this time period, some Central American leaders have opposed the U.S. strategy, believing it to be counterproductive to obtaining peace in

the region. The leaders of El Salvador and Honduras, however, actively supported the U.S. position, believing the Sandinistas to be direct threats to their security. Nicaraguan opposition leaders with whom we met were also not unified in their support of U.S. policy. Some stated that it invested too heavily in the military option, did not follow through, and largely ignored other tactics, such as more active support of the civic opposition. Some also believed that U.S. sanctions have not had the intended result of reducing the power base of the government but had contributed to the exodus of the educated middle class and potential opposition leaders; some U.S. Embassy officials agreed with this position that U.S. policy was contributing to the "Cubanizing" of Nicaragua. Other opposition leaders expressed concern that the unilateral and overt U.S. strategy was converting a Nicaraguan problem into a United States versus Nicaragua issue and putting them at more personal risk than was necessary. The leaders called for a more regional, multilateral approach so that being anti-Sandinista would not necessarily be viewed as being pro-United States. Nevertheless, some opposition and all contra leaders believed that military pressure was and still is essential.

The government of Nicaragua has promised elections in 1990 and claims that it does not and will not actively support the insurgents in El Salvador. It has released some political prisoners, permitted more freedom of the press, and reportedly has allowed the private sector limited space to operate without strict government control. Nicaraguan opposition and U.S. government officials point out that these pledges were made before with little long-term effect. It is speculative as to whether this is a permanent improvement and, if so, whether it is the result of direct and unilateral U.S. actions, regional peace efforts, or a combination of both. For example, according to Sandinista government officials with whom we met, the U.S.-supported contras and U.S.-imposed economic sanctions were the primary cause of their failed economy, the justification for the largest army in the region, and the reason they could not democratize, as they were in effect at war. Further, they stated that U.S. policy isolated Nicaragua from the West and forced them into further alignment with the Eastern bloc. The recent announcement by the Bush administration that it will not seek lethal aid for the contras and will actively support the regional peace efforts will deny the Sandinistas further pretexts for not following through on their promises to support security and democracy. Though the contras' military pressure did not impel the Nicaraguan government to take significant steps toward democracy, the administration credits the contras' military pressure as instrumental in bringing the Nicaraguan government to sign the peace pact. Nicaraguan officials told us that the Esquipulas II regional peace plan provided the

impetus to begin a dialogue concerning the contras. At this time, there is a bipartisan consensus in the United States to encourage a peaceful resolution but also to support the contras as a source of pressure on the Nicaraguan government to follow through on its pledge to institute greater democratic freedoms. The contras indicated they would return to Nicaragua only if such freedoms are guaranteed.

At this time, the majority of the contras are being supported in base camps in Honduras with humanitarian aid. According to Honduran officials, the increasing number of contras, family members, and supporters fleeing Nicaragua could raise economic, political, and internal security problems for Honduras if they continue to remain in Honduras. They have urged U.S. officials to assume responsibility for the resettlement of the contras if aid is not resumed. Meanwhile, both Nicaragua and the United Nations are reportedly preparing plans for the resettlement or repatriation of the contras. The March 1989 Bipartisan Accord on Central America, which appropriated nearly \$50 million in humanitarian assistance for the contras, stipulates that funds may be used for the contras' voluntary reintegration and/or relocation into Nicaragua.

The U.S. Presence in Honduras

To increase the Honduran military's ability to deter potential Nicaraguan aggression, the United States provided the Honduran armed forces with \$398 million in MAP and FMS funding to provide air and naval support and to improve force mobility and combat readiness. The United States also provided deployment training to enhance capabilities of and relations between U.S. and Honduran armed force units. Approximately 1,100 U.S. military personnel have been present at Soto Cano Air Base—formerly Palmerola Air Base—since 1983 (1) to support U.S. training exercises and U.S. intelligence activities in Honduras, (2) to signal U.S. resolve to support its allies against the Cuban/Nicaraguan threat, and (3) to assist the Honduran military in providing humanitarian aid and civic action to remote areas. Although opinion polls indicate that this U.S. presence has been well received by most Hondurans, it is also the source of unfavorable press and has attracted occasional terrorist acts. In addition, according to U.S. Embassy officials, U.S. efforts to maintain a presence at Soto Cano have prompted Honduran officials to seek a bilateral defense agreement and preferential treatment in exchange for use of Honduran facilities and support of U.S. policies in the region. U.S. government officials stated that the United States is not planning to construct permanent facilities and emphasized that there are no plans to relocate U.S. military operations to Honduras after their scheduled termination in Panama.

Guatemala and the Lethal Aid Debate

The debate continues over whether or not to reinstate lethal U.S. military aid to Guatemala. U.S. concerns about excessive human rights abuses by the Guatemalan military resulted in a prohibition in the fiscal year 1986-87 Foreign Assistance Act on the use of the U.S. funds to purchase lethal military arms and ammunition. The United States began providing nonlethal aid to Guatemala in 1985 to support Guatemala's counterinsurgency campaign and to recognize its democratically elected government. From fiscal year 1986 to 1988, Guatemala received \$19 million in MAP funding to repair or acquire nonlethal military, engineering, transportation, and communications equipment. Guatemala has been able to reduce the number of insurgents to a relatively low level, but it has been unable to prevent the insurgents from continuing terrorist and propaganda campaigns. The suspension of U.S. military assistance produced major shortages of military equipment. Although U.S. prohibitions against Guatemala's use of MAP funds to purchase lethal weapons could not prevent Guatemala from purchasing some lethal weapons from the United States and other countries with its own funds, purchases have been limited by budget constraints, according to Guatemalan and U.S. officials. U.S. and Guatemalan military officials point to Guatemala's efforts to establish democratic processes and institutions and its budget restraints as justification for reinstating lethal aid. However, other U.S. experts on Central America and U.S. and Guatemalan human rights groups believe that Guatemala's human rights record and the limited effectiveness of institutions created to investigate human rights abuses still do not justify the reinstatement of lethal aid.

The Outlook for Regional Security

Past U.S. policies in the region appear to have been driven largely by the threat of an increasing Soviet bloc influence in the region and, more specifically, the threat posed by Nicaragua. However, despite Nicaragua's military buildup, Central American officials believe that Nicaragua is not likely to engage in open warfare with its neighbors, particularly in view of its current economic situation. Further, in their view, if Nicaragua were to openly attack any of the Central American nations, the United States would provide for their defense. Nevertheless, domestic problems within each country could continue to stall the attainment of regional stability.

Some experts at our Washington and San Jose conferences believe that in the process of modernizing Central American militaries, the United States may also have increased their power to the detriment of civilian governments. The Salvadoran armed forces improved their capabilities but increased approximately threefold during the 1980-88 period. While

the Honduran military has remained at roughly the same size during the same period, some U.S. experts on Latin America believe that continued high levels of military aid to both Honduras and El Salvador could further undermine civilian efforts to gain control of the military. Others oppose aid to the Guatemalan military for similar reasons. At this time, however, all three militaries are supporting their elected officials. Whether or not the militaries wield unacceptably high levels of power behind the scenes, as some critics contend, is difficult to determine. Nevertheless, the United States should ensure that any U. S. military assistance is balanced with programs to support democratic institutions and improve the management capabilities and skills of the civilian administrators.

Domestic and host-country conditions have also hampered the effectiveness of the U.S. security assistance programs. For example, limited funding has slowed progress toward modernization in Costa Rica and Guatemala. In Honduras, MAP allocations will be used over a 3- to 4-year period for a major aircraft acquisition, thereby delaying purchases of helicopters and other needed equipment into the future. In the area of training, as evidenced in the region, courses aimed at teaching the military respect for human rights and democracy are not necessarily successful. Participant selection, military advancement, and rotational policies within the host countries sometimes result in the ineffective placement and use of U.S.-trained individuals. Further, some country officials indicated that U.S. training does not always fill their needs. For example, Costa Rican officials said that they did not need infantry training but rather instruction in investigative techniques, refugee management, and border patrol.

In addressing the overall thrust of the U.S. strategy toward the region, the consensus of the U.S. experts who attended the GAO conference in Washington, D.C., was that the relative strength of militaries vis-a-vis weak civilian governments, government ineffectiveness in addressing social problems, drug trafficking, corruption, pervasive poverty, social inequities and injustice, and growing numbers of refugees and displaced persons also pose substantial threats to the region and should have figured more predominantly in decisions on U.S. strategies. Central American government officials generally agreed that the United States needs to focus on these major political and socioeconomic problems, which represent the underlying causes of instability in Central America and give rise to social unrest and insurgencies. U.S. government officials contended that these factors were considered but that the results were uneven because of the complexity of the situation.

Conclusions and Matters for Congressional Consideration

While some U.S. programs had a positive impact on regional security, others accomplished less than anticipated and in some cases contributed to or created new problems in the region. Massive levels of U.S. assistance helped the Salvadoran military to counter the challenge from leftist insurgents, thereby preventing Soviet bloc expansionism. However, this success came at a cost to U.S. socioeconomic objectives for the country and created a Salvadoran dependence upon U.S. assistance. U.S. support of the contras kept pressure on the Sandinista government to democratize but hampered implementation of the regional peace plan, which required removal of all insurgent forces. Further, the future of the contra forces is now a concern to Honduras. Finally, in our opinion, overreliance on unilateral strategies to achieve regional security has been interpreted by Central Americans as weak U.S. support for Central America's regional peace plan, even though the United States publicly supported it. In addition to the threat posed by Nicaragua, the political stalemate in Panama has heightened concerns about the security of U.S. personnel and the security and operations of the Canal after 1999 (see app. III for further discussion).

Long-term regional stability cannot be achieved until the socioeconomic problems are adequately addressed. However, long-term strategies for rectifying these problems cannot be effectively implemented until current conflicts are resolved. Our analysis strongly suggests that the United States should join with El Salvador, Honduras, Guatemala, and Costa Rica in support of Central American initiatives such as the revived Esquipulas II regional peace plan. This plan provides a framework for Central Americans to address current conflicts. The United States can support this effort by using this framework to address the major foreign policy issues it faces in the region. The current administration has demonstrated a greater willingness to move in that direction, even if the recent bipartisan Central American agreement does not call for the immediate repatriation of the contras.

Our analysis suggests that to further promote regional security, the United States should support the peace plan by discussing with the Central American presidents the U.S. role in (1) promoting a regional solution on the future of the contras, (2) monitoring and verifying compliance with the plan's provisions, and (3) formulating penalties for noncompliance and incentives for compliance.

Increased U.S. dialogue with the Central American countries within the framework of the regional peace plan would entail increased multilateral dialogue with the Soviet Union, Nicaragua, and possibly Cuba. Nevertheless, unless both Soviet and Cuban military aid to Nicaragua and the size of the Nicaraguan military are reduced in response to any demobilization of the contras, Nicaragua will continue to pose a security threat to the region. Improved U.S.-Soviet relations and the Soviet Union's need to reduce financial outlays abroad offer opportunities for both countries to discuss a reduction of their military involvement in the region.

Agency Comments

Overall, the Department of State expressed concern over our characterization of U.S. efforts to achieve regional stability, requesting more emphasis on U.S. contributions and limits placed on the achievement of U.S. objectives by conditions in each country. We believe these issues are discussed in this or other chapters of the report. Further, the Department stated that peace has not been achieved because of the actions of the Sandinista government of Nicaragua. We recognize that the government of Nicaragua has contributed to the problems in the region. We believe, however, that those domestic social, political, and economic injustices that caused the rise of discontent in Central American countries are similarly important in explaining the absence of peace. All of the Department's comments and our responses are included in appendix IV. DOD did not supply written comment, but we obtained informal comments from appropriate DOD officials and incorporated them where appropriate.

Fragile Democracies Face Major Challenges

Although the precise impact of U.S. programs and policies on the movement toward democracy is difficult to measure, U.S. and host country officials generally agreed that progress toward democracy has been made during the 1980s throughout Central America with the exceptions of Nicaragua and Panama. The well-established Costa Rican and relatively new Belizean democracies have not been challenged, and El Salvador, Guatemala, and Honduras have made progress in their democratic transitions. On the negative side, both the Marxist Sandinista government in Nicaragua and the military-dominated regime in Panama remain firmly in place without major concessions to democracy. Despite the progress made in the rest of Central America, continuing violence, inequitable socioeconomic conditions, drug trafficking, corruption, and other conditions pose significant challenges to the fragile, evolving democracies. These conditions could negatively affect democratic transitions throughout the region unless democratic institutions and processes are further strengthened.

U.S. Strategies for Strengthening Democracy

The United States has followed multiple strategies in attempting to strengthen democracy in Central America. It provided ESF assistance to enhance the economic stability of democratic governments, development assistance to improve the environment for democracy to grow, and security assistance to protect democratic governments from insurgents and potential external aggression. Diplomatically, the United States promoted and supported free elections, adherence to human rights principles, and a proper role for the military in relation to civilian governments. As part of the Central American Initiative, the United States expanded or introduced specific programs to strengthen electoral systems, improve judicial and legislative processes, promote respect for human rights, broaden participation in democratic processes, and reinforce democratic ideals. Finally, the United States provided aid to the contras and imposed economic sanctions against Nicaragua and, more recently, Panama to pressure these governments to democratize.

The major U.S. departments and agencies implementing democratic initiatives were the Departments of State and Defense, which encouraged government and military respect for human rights; the Department of Justice, which assisted State in providing police-related training; AID, which administered a wide array of democratic initiatives in the areas of elections, judicial reform and training, legislative and municipal government development, media development, democratic publications, U.S. scholarship opportunities, and others; the United States Information Agency, which continued existing educational and cultural exchange

programs to reinforce democratic values and counter Soviet bloc influence; and the Peace Corps and the U.S.-funded Inter-American Foundation, which implemented programs aimed at increasing grassroots participation in economic activity and decision-making.

Other U.S.-funded private entities also participated in the U.S. effort. The National Endowment for Democracy channeled funds through (1) the American Institute for Free Labor Development to promote the growth of democratic labor unions, (2) the Center for International Private Enterprise to advance private enterprise and assist business associations, (3) the National Republican and National Democratic Institutes for International Affairs to assist political party organization and development, and (4) other private grantees to promote democratic pluralism. Other U.S.-funded private voluntary organizations sponsored certain development programs aimed at broadening popular participation in democratic processes, including the development of cooperatives and the integration of women and indigenous populations into the development process.

The U.S. Congress has taken specific steps to promote democracy through various legislative actions. For example, it (1) influenced administration policy regarding the contras; (2) authorized and earmarked funds to strengthen the administration of justice in Latin American and Caribbean countries; (3) permitted funds for police training in El Salvador and Honduras, provided that certain conditions were met; (4) required that aid to El Salvador and Guatemala be suspended if their elected governments were deposed by military coup or decree; and (5) placed various stipulations on aid to El Salvador and Guatemala based on human rights concerns. While other forms of economic assistance to Nicaragua were suspended, the Congress earmarked funds for the National Endowment for Democracy to support the democracy-related activities of private grantees inside Nicaragua. Regarding Panama, few democracy-oriented programs were implemented.

Progress Made, but Substantial Challenges Remain

With the exceptions of Panama and Nicaragua, progress was made toward establishing credible electoral processes, strengthening judicial systems, and encouraging adherence to human rights principles throughout Central America. U.S. and host government officials believe that U.S. programs have played an important role in this progress. However, democratic institutions and processes remain fragile and need to be further strengthened if the substantial challenges to democracy are

to be effectively met. Moreover, it may be difficult for host governments and regional institutions to sustain some U.S. initiatives.

Elections

The most prominent measure of the growth of democracy in Central America has been the transition from military to elected civilian governments in El Salvador, Honduras, and Guatemala. Since 1982, El Salvador has held six elections, including the March 1989 presidential election, in which the conservative Nationalist Republican Alliance (ARENA) party defeated the incumbent Christian Democratic Party (PDC). Although violence surrounding the election prevented many from voting, a coalition of left-of-center parties with ties to the insurgency entered the Salvadoran elections for the first time, thereby permitting the Salvadoran people to choose public officials from a more representative political spectrum. The 1985 Honduran presidential election marked the first time that one popularly elected civilian government succeeded another. The cooperation exhibited between the civilian government and military leaders since Guatemala's transition to a civilian democracy in 1985 is a significant departure from the past. An AID evaluation of U.S. electoral assistance concluded that direct U.S. technical assistance and limited funding to electoral commissions coupled with U.S. support for the regional Center for Electoral Assistance and Promotion (CAPEL) probably helped to establish the credibility of elections in these countries.

Despite these transitions to civilian government, the existence of elections has not allayed the concerns of many Central Americans over the relative strength of the military in relation to the still weak civilian governments. Some of the Central Americans who attended our conference in San Jose believe that the real power in their countries remains in the military and that if a crisis occurred, the military would reassert its power. (See app. II.) One State Department publication, in outlining the challenges to democracy in Central America, notes that "the risk of renewed military interventions will increase again in direct proportion to the difficulties democratic governments will have in coping with economic and social problems and in fighting insurgency, terrorism, and the illegal narcotics traffic." The Department concludes that civil-military cooperation will be critical in dealing with these challenges to democracy.¹

¹Democracy in Latin America and the Caribbean: The Promise and the Challenge, U.S. Department of State, March 1987.

Judicial Reform and Administration of Justice

The State Department believes that, throughout Central America, civilian institutions critical to democracy's proper functioning, such as judicial systems, the press and media, electoral procedures, and political parties, remain fragile and need to be further strengthened. In this connection, in the area of judicial reform, AID (1) financed assessments of the judicial systems throughout Central America and formulated bilateral assistance programs to address identified needs; (2) encouraged governments to establish national commissions to stimulate needed reforms; (3) sought to improve the institutional capacities of the courts through judicial training, technical assistance, equipment, and facilities; (4) provided funding, training, and equipment for a special investigations unit and a forensic unit in El Salvador to improve the government's capacity to investigate sensitive crimes; and (5) helped strengthen the capacity of the Latin American Institute for the Prevention of Crime and Treatment of Offenders (ILANUD) to extend judicial training throughout the region.

U.S. government officials readily acknowledged that, despite these efforts, overcoming the serious deficiencies in most Central American judicial systems has to be considered a long-term process and that substantial improvements cannot be expected soon. For example, in El Salvador, where the United States has had a judicial reform program since 1985 and where it has made the greatest financial commitment, U.S. government officials noted that the public continues to question the credibility of the judicial system because (1) the military continues to shield its officers from the normal judicial system; (2) the government unit investigating sensitive crimes is headed by military officers, raising questions over its impartiality; and (3) the political appointment and frequent turnover of judges negates the effectiveness of training and works against the goal of a professional judiciary.

The modest accomplishments achieved thus far, the sensitivity of some of the activities being undertaken, and, in the view of some U.S. government officials, the lack of political will by some governments to improve their systems have led Congress to question whether administration of justice programs should be continued. Several nongovernmental participants espoused this view of AID's administration of justice programs in El Salvador, Guatemala, and Colombia at a March 1989 symposium sponsored by the Washington Office on Latin America and the American University. U.S. government officials, while acknowledging these difficulties, noted that U.S. efforts toward judicial reform were first instituted in 1985 and that insufficient time has elapsed to expect substantial progress.

Human Rights

In the area of human rights, U.S. government officials and Central American observers of human rights agreed that the overall human rights situations in Central America had improved over conditions in the early 1980s; however, they also noted that abuses still occur at unacceptable levels in all countries except Costa Rica and Belize. For example, according to statistics collected by the U.S. Embassy in El Salvador, the average number of apparently politically motivated deaths per month declined from about 800 a month in 1980 to 32 a month for the first 6 months of 1988. However, U.S. government officials voiced concern that the number of deaths had gradually increased over the past year. The head of Tutela Legal, the human rights organization of the Catholic Church in El Salvador, agreed that this has been the general trend but noted that Tutela Legal consistently reports higher numbers of abuses than either the Salvadoran government or the U.S. Embassy. U.S. and host country government officials in Honduras and Guatemala also noted overall improvements in the human rights situations in these countries over the decade but said that these countries had also experienced a rise in violence over the past year.

U.S. government officials in El Salvador, Guatemala, and Honduras believe that the U.S. tactics used to encourage improved performance on human rights—legislative conditionality, diplomatic overtures, direct technical assistance to human rights commissions, and U.S. support to the regional Inter-American Institute of Human Rights (IHR)—have contributed to the overall improvement of the human rights situation. They offered various possible explanations for the recent increases in violence and human rights abuses and noted that although host governments may not condone abuses, they are unable to completely eliminate them. U.S. government officials in El Salvador told us that the human rights situation was not likely to improve substantially as long as (1) the armed conflict continues, (2) major elements of the civilian population and military establishment lack confidence that justice can be fairly served through existing judicial channels, and (3) weak civilian institutions are unable to control public violence and hold the military accountable for its actions.

Sustainability of U.S. Initiatives

U.S. government officials also raised the issue of sustainability of U.S.-supported democracy initiatives. For example, AID was able to substantially improve the capabilities of the three regional institutions extending assistance on human rights problems, election procedures, and judicial training throughout the region—IHR, CAPEL, and ILANUD.

However, U.S. government officials conceded that none of these organizations could effectively continue their activities in the absence of substantial U.S. aid or a broadening of their base of financial support. For example, according to AID, ILANUD relies on AID for 90 percent of its total funding, and even the United Nations, which ostensibly sponsors the organization, provides minimal financial support. Other U.S.-financed programs, such as El Salvador's special investigative unit and forensic unit, are also highly dependent on U.S.-provided training, technical assistance, and sophisticated equipment.

Outlook for Democracy

The uneven gains toward democracy in the region underscore the reality that the movement toward democracy must be considered a long-term process. Some of the institutions and processes that characterize democracy—subordination of the military to a civilian government, equal treatment under the law regardless of social position or wealth, and popular participation in decision-making—have not been part of the historical tradition of some Central American countries, and changes in that direction may evolve only gradually. As a case in point, Panama's move toward democracy during the early 1980s was eventually suppressed by the traditional dominance of the military. Recent events in Panama clearly indicate that the military dominates the civilian sector, the judiciary, and the legislature, and limits, if not entirely inhibits, popular participation and decision-making. (See app. III.)

It may be too early to measure the impact of the democratic initiatives that the United States has sponsored in Central America. Although the impact of these programs may currently appear modest, their cumulative effect on a country's movement toward democracy could be substantial over time.

There was general agreement at our conference that the United States should assist democratic transitions in the region, although opinions differed on the best way to do this. The general consensus, with which we concur, was that the Central American societies themselves must commit to democracy in order for it to be lasting. Accordingly, some former Central American government officials and academicians felt that the United States should support Central American initiatives when possible to reinforce the internal commitment to democracy. They pointed to assistance channeled through indigenous organizations, such as those organizations funded by AID, the National Endowment for Democracy, Inter-American Foundation, and others, as affording the advantage of both reinforcing societal elements working toward democratic changes

and lowering the U.S. profile in sensitive areas. Similarly, U.S. support to regional institutions extending technical assistance in elections, human rights, and judicial training was seen by all participants as a positive way to advance U.S. goals in these areas. While we agree that U.S. assistance to these regional institutions should be continued, we believe that a strong effort should be made to reduce their dependence on the United States by helping them broaden their base of support.

While some democratic initiatives may be more effective if channeled through private organizations, the experts felt that the U.S. government should assist Central American governments directly in strengthening their weak civilian institutions, which remain susceptible to domination by their comparatively strong militaries. Through balanced efforts to strengthen both civilian and military institutions, the United States can help increase both the accountability of civilian governments to their populations as well as the accountability of the military to their civilian governments. In the process, the United States may also be able to help Central American countries reduce the corruption and inefficiency that continue to undermine public confidence in both military and civilian institutions.

To establish and maintain credibility in pursuing the goal of democracy, we believe that the United States must be more consistent in its promotion of this goal. The State Department acknowledges that a commonly held view in Latin America is that, in the past, the United States has sacrificed democratic principles and even encouraged repressive military regimes in the pursuit of U.S. policy goals. To overcome this perception, participants at our Washington conference emphasized that if the United States is to tout free elections, then it must be prepared to accept the winner in any freely conducted election, even though the United States may not prefer that particular candidate. However, this does not suggest that the United States should support the winner of a fraudulent election, as discussed in appendix III with reference to Panama. Similarly, if the United States is to seriously promote adherence to human rights principles, then it must take a stronger stand when it becomes clear that human rights have been abused without an appropriate government response.

U.S. government officials consistently noted that high-level dialogue with civilian and military leaders—such as the 1983 visit by then Vice President Bush to El Salvador—and past diplomatic demarches have been effective in stemming the tide of abuses. U.S. officials hope that the February 1989 visit to El Salvador by Vice President Quayle, during

which he emphasized the importance that the United States places on human rights, will have a similar impact. Some U.S. officials also supported the selective use of conditionality to improve human rights performance but emphasized that aid should be conditioned on actions within the government's control. Conditioning aid on government support for human rights education and training in the general public as well as military and security units and actions to forcefully and impartially investigate and bring to justice all those found to violate human rights, regardless of social class or position, would appear to be reasonable conditions.

Even with these mechanisms for encouraging adherence to human rights principles, it must be recognized that only so much progress can be made in the human rights area until major progress is achieved in judicial reform. U.S. government officials in El Salvador noted that human rights abuses in that country would likely continue as long as the armed conflict continues and the public and the military alike lack confidence that justice can be served through existing judicial systems. Discussions with Salvadoran judicial and municipal government officials confirmed the widely held view that the country's inequitable system of justice is one of the principal causes of that country's insurgency. Because of the interrelationship of the armed conflict, social injustice, and human rights abuses in El Salvador and Guatemala—and the latter two in Honduras—we believe that U.S. assistance to improve the administration of justice throughout Central America should continue to be an important element of the U.S. effort.

Conclusions and Matters for Congressional Consideration

To sustain the progress made in the democratic transitions in Central America and to address the many challenges that remain, the United States needs to make a long-term commitment to assist Central America in strengthening democratic institutions and processes. In our opinion, attainment of these goals would benefit from a stronger U.S. effort to solicit support from other donors. However, democratic initiatives alone cannot do the job. Civilian governments will continue to be hampered in pursuing democracy as long as their countries face armed conflict and the underlying causes of the conflicts—poverty, injustice, economic instability, and corruption. Efforts to strengthen democracy must be concurrent with efforts to address these other problems.

Agency Comments

The Department of State commented that the report's conclusions should have better reflected the roles of U.S. diplomacy and dialogue

with the Central American countries and should have placed the limited democratic progress achieved in El Salvador in a comparative context to better reflect that country's substantial achievements and capacity for more democratic reforms. We believe, however, that we have highlighted both the roles of diplomacy and dialogue and the need to view the gains made in El Salvador over the long, rather than short, term. The Department was also concerned that we did not identify the qualifications or special interests of individuals whose opinions we included. We adjusted the report to better identify the sources of these opinion whenever possible. The comments and our in-depth responses are included in appendix IV.

Uneven Success in Meeting Economic Objectives

The funds provided under ESF assistance stimulated economic activity and helped halt economic declines in Costa Rica, Belize, Guatemala, El Salvador, and Honduras. Parallel efforts by the United States to promote economic stabilization, and subsequently structural adjustment, were relatively successful in Costa Rica, Belize, and Guatemala but less successful in El Salvador and Honduras. U.S. economic sanctions against Panama and Nicaragua contributed to the economic disruption in each country.

U.S. Approach to Stabilization and Structural Adjustment

In the early 1980s, AID changed its foreign assistance approach from the focus on basic human needs pursued during the 1970s to a focus on economic policy reform. Under the assumption that (1) the focus on basic human needs had failed to promote sustainable economic growth and development and (2) developing countries' policies on the allocation, mobilization, and distribution of economic resources most affect growth and development, AID began conditioning its ESF balance-of-payment and budget support assistance on host governments' adoption and implementation of economic policy reforms.¹ Economic stabilization and structural adjustment reforms by the Central American governments were seen as necessary to achieve self-sustaining growth and development; the return of private capital that had been sent abroad; and strengthened civilian, democratic governments.

The United States used ESF assistance for short-term economic stabilization programs that permitted countries to manage problems caused by recurring balance-of-payment and budget deficits. Through policy dialogue and conditions on the disbursement of ESF, the United States encouraged governments to adopt policies to reduce public and private expenditures. The stabilization programs included measures such as exchange-rate devaluation, elimination of arrears on international payments, increases in central bank reserves, and limits on domestic credit expansion and foreign borrowing.

Once the countries' economies were stabilized, the United States used ESF to promote longer-term structural adjustment programs. These programs encouraged the restructuring of a country's economy to increase export-generated revenues to balance import and debt-servicing costs. The United States sought to increase host countries' foreign exchange earnings and growth in real gross domestic product by encouraging

¹Foreign Assistance: U.S. Use of Conditions to Achieve Economic Reforms (GAO/NSIAD-89-177, Aug. 25, 1986).

them to direct resources into productive investments, particularly into the export sector.

Successful Efforts in Costa Rica, Belize, and Guatemala

U.S. efforts to promote stabilization and adjustment in Costa Rica, Belize, and Guatemala were successful because (1) the governments recognized the need for and were committed to reforms, (2) the governments secured internal support for reforms, (3) except for Guatemala, the International Monetary Fund (IMF) and/or World Bank had programs complementary to those of the United States, and (4) the United States did not have competing political or security interests that overrode its economic objectives.

The United States has provided \$815.0 million in ESF assistance to Costa Rica through fiscal year 1988. Because of the close cooperation between the United States, IMF, and the World Bank and a commitment to reform on the part of the Costa Rican government, which had the support of its population, a degree of economic stability was achieved by 1984. U.S. assistance and attached conditions were crucial to government efforts to bring about exchange rate stability and a reduction in the rate of inflation. Changes in the currency and banking laws allowed private commercial banks direct access to the Central Bank's credit operations and permitted dollar-denominated lending² by all credit institutions, which improved support for private-sector, export-related activities. The government also began divestiture of the state-owned holding company, which lacked the technical and management skills needed to make it financially viable, and adopted reforms directed at devaluation and unification of the exchange rate with subsequent on-going mini-devaluations as needed, market-based interest rates, expansion of private-sector banking, elimination of many price controls, and targeted credit allocations. Private-sector growth in nontraditional exports has increased, as have private capital flows, and unemployment declined. However, Costa Rica's external commercial debt of \$2.6 billion and its debt-servicing burden remain serious threats to future economic growth. Despite significant increases in nontraditional export growth,³ Costa Rica's foreign exchange earnings will remain insufficient for the foreseeable future to pursue economic growth while servicing and reducing its debt. AID's "Debt for Development Initiative," announced on

²Dollar-denominated lending uses U.S. dollars rather than local currency in the transaction process (lending and repayment).

³Caribbean Basin Initiative: Impact on Selected Countries (GAO/NSIAD-88-177, July 1988), discusses foreign exchange earnings from nontraditional exports.

February 15, 1989, could be used to assist Costa Rica in reducing its commercial debt burden.

Belize has a very small labor force and extremely underdeveloped infrastructure. Almost any negative internal or external economic development can have a great impact on the country. Although the bulk of external assistance comes from Great Britain, the United States has provided about \$30.0 million in ESF assistance since fiscal year 1982. The 1985 and 1986 IMF arrangements, U.S. dialogue, and conditionality have been important in encouraging the Belizean government to undertake the reforms necessary for stabilization and to begin economic adjustment.

With the support of the Belizean public, government finances have been strengthened, monetary policy has been tightened, and external arrearages have been eliminated. Export and import procedures have been liberalized to encourage foreign exchange-generating exports and have resulted in balance-of-payment surpluses since 1985. Net international reserves have increased and the currency is stable. Belize's economy remains highly vulnerable to external forces.⁴ Its citrus and banana exports have been successful because the fruit is sold under preferential trading arrangements with the European Economic Community. One-third of Belize's export earnings is from sugar exports, which face an uncertain future. With U.S. assistance, the Belizean government is attempting to attract foreign investment in order to diversify its export base, but it is hampered by its small labor pool, high wage rates and utility costs, and poor infrastructure such as roads and ports.

Guatemalan economic decline has been arrested, stabilization has been achieved, and adjustment is underway. The Guatemalans' success is due to (1) the government's recognition of its economic problems and commitment to reform, (2) internal support for economic reforms, and (3) the U.S. emphasis on economics and its provision of ESF assistance. The Guatemalan government designed its own program, which was discussed with the various sectors of Guatemalan society and subsequently endorsed and supported by the United States. The U.S. ESF balance-of-payments assistance, totaling \$265.0 million since 1985, was timely, appropriate, and of critical importance to Guatemala's success. Although there has been considerable repatriation of private capital, Guatemalan government officials said that \$1.5 billion still remains

⁴See footnote 3, chapter 4 (GAO/NSIAD-88-177, July 1988).

outside the country. The ability to generate sufficient revenues for government operations remains hampered by problems with the tax system that is poorly administered, has a weak audit capacity, and lacks taxpayer identification. A major impediment to foreign investment and expanded growth is the inadequate infrastructure. Although the government formed a presidential commission to address divestiture of state-owned entities such as the telephone system, airline, and merchant marine, no actions had been taken at the time of our review. The telephone system functions so poorly that potential investors have revised investment plans and located elsewhere, the merchant marine had no ships but nonetheless received budget support, and the national airline was subsidized and rented its few planes from the military. The Guatemalan government is reportedly replacing civil servants down to the first-line supervisory level with party loyalists, further hampering government operations, which are already inefficient and lack institutional capacity. Guatemala's export profile has improved, but investment continues to be inhibited by poor infrastructure and services, uncertainties about Guatemalan political stability, and perceived risks associated with the Salvadoran and Nicaraguan military conflicts.

Less Successful Efforts in El Salvador and Honduras

Although ESF assistance has halted economic declines in El Salvador and Honduras, the United States has been less successful in achieving stabilization and adjustment due in part to (1) the reluctance of the countries' governments to undertake reforms, (2) domestic opposition to U.S.-advocated reforms, (3) the absence or interrupted presence of other external donors' stabilization and adjustment programs, and (4) U.S. political considerations that overrode AID's imposition and enforcement of strict conditionality related to economic reforms.⁵

The United States provided over \$1.3 billion in balance-of-payment and budget-support assistance to El Salvador, conditioned on reform of its economy, between fiscal years 1981 and 1988. U.S. policy dialogue and ESF agreements have focused on those reforms necessary for stabilization and subsequent adjustment. Stabilization remains hampered by the effects of the 1986 earthquake, the continuing internal military conflict, and the government's reluctance to undertake comprehensive reforms that would be politically threatening. AID has attempted to pressure the Salvadoran government to adhere to its agreements by withholding ESF

⁵Providing Effective Economic Assistance to El Salvador and Honduras: A Formidable Task (GAO/NSIAD-85-82, July 1985).

disbursements. However, U.S. political concerns for maintaining democratic institutions, improving human rights performance, and pursuing the war against Marxist insurgents resulted in disbursements without compliance, followed by the weakening of conditions and their effectiveness. In 1986-87, the United States shifted its emphasis on reform, lowered its expectations, and sought more participation by the Salvadoran government in designing stabilization and adjustment measures under its national plan. Although ESF assistance to El Salvador has not secured the implementation of key stabilization and adjustment measures, it has kept the economy afloat and growing at a modest rate.

Until late 1986, the situation in Honduras in some respects paralleled that of El Salvador. The U.S. need for the Honduran government's support of the Nicaraguan contras became a higher priority than economic reforms and reduced AID's leverage to encourage economic reform measures in Honduras. The United States provided Honduras with over \$555 million in ESF assistance during fiscal years 1982-88. This support was conditioned on the Honduran government's taking steps to implement a wide range of reforms to address such issues as fiscal and balance-of-payment deficits, excessive protection of domestic industry, exchange rate adjustment, import restrictions, price controls, inadequate tax generation and collection, and distorted interest rates. However, the Honduran government has tended to view U.S. assistance as a substitute for undertaking agreed-upon reforms and has become dependent upon external assistance. The Honduran government has recently begun to recognize the need for basic economic reforms and has been more amenable to reforms suggested by the United States. However, past performance by the Honduran government raises questions about its actual commitment to reforms. Further, Honduras lacks the infrastructure and public services to attract the investment necessary for economic growth and job generation, and external factors such as the civil war in El Salvador, unsettled situation in Nicaragua, and the limited prospects for revived interregional trade further inhibit economic progress.

U.S. Economic Approach to Panama and Nicaragua

ESF assistance of \$56 million for Panama was intended to support a 1983 stabilization program and was tied to government policy reforms. Uneven progress was occurring when U.S.-Panamanian relations deteriorated. In 1987-88, with the exception of certain humanitarian assistance, all economic and military aid and trade benefits were suspended by the administration and the Congress, and Panamanian assets in the United States were frozen. The U.S. economic sanctions caused an

already bad economic situation to become worse, but fiscal manipulations by the Noriega regime enabled it to evade some sanctions. The United States had made these exemptions to permit the U.S. private sector to continue operating in Panama and to avoid certain adverse effects on private citizens. The exemptions were not intended to benefit the Panamanian regime.

Marked deterioration in the Nicaraguan economy from 1984 on is attributable to economic disruptions caused by the civil war, Sandinista mismanagement, and, to some extent, U.S. sanctions. By some estimates, inflation is running at 20,000 percent per year, forcing greater resort to a barter economy. Productivity has gone down and corruption has increased. An estimated 80,000 people fled the country during 1988. The deterioration of Nicaragua's economy has been aggravated by U.S. economic sanctions, but the sanctions have been evaded to some extent by the government. Sandinista officials have used the sanctions as an excuse for their own failed economic policies. However, the growth of the informal sector and the move to barter exchange for both domestic and foreign transactions suggest that actual production in Nicaragua is greater than might appear from the formal economic indicators.

Conclusions and Matters for Congressional Consideration

Costa Rica will not be able to generate adequate foreign exchange in the foreseeable future to service its commercial debt obligations. This debt remains the primary obstacle to the United States' achieving its objectives in Costa Rica. Costa Rica will not be able to achieve self-sustaining economic growth, and costs to the United States in the provision of assistance will continue in the absence of commercial debt relief. The United States could assist Costa Rica in a commercial debt relief program through AID's debt for development initiative.

The United States has helped stabilize Belize's economy with relatively small levels of assistance. Since comparatively minimal amounts of aid are necessary to assist Belize in restructuring its economy and avoiding the economic problems contributing to the sociopolitical unrest in much of Central America, this assistance should continue.

To encourage investment and economic growth, the United States should encourage the Guatemalan government to privatize inefficient state-owned companies, particularly the national telephone system.

Chapter 4
Uneven Success in Meeting
Economic Objectives

Effective steps toward economic reform in El Salvador will likely be delayed, and additional and prolonged U.S. ESF assistance will be required due to the political and security situation.

U.S. concern over maintaining Honduran support for the Nicaraguan contras gave the Honduran government leverage to resist adopting the reforms promoted by the United States. If solutions to the Nicaraguan contra situation are found, future assistance to Honduras should be more strictly linked to the implementation of effective economic policy reforms. In the absence of such reforms, prolonged ESF assistance will be required.

Agency Comments

The Agency for International Development and Department of State agreed with our assessment of economic stabilization and structural adjustment. Each also had minor points of clarification and/or disagreement. Their comments and our response are included in appendix IV.

Broad-Based Development: Achievements and Challenges for the Future

U.S. assistance has helped Central American countries to maintain higher living standards than otherwise would have been possible. However, the region has yet to attain the level of development envisioned by the Kissinger Commission. With the exception of Costa Rica, Central American countries remain severely limited in their ability to deliver social services to the poor and to generate jobs and income opportunities needed for their economic advancement. Considering that widespread poverty and economic inequity continue to exist, in some countries at levels worse than a decade ago, officials implementing the Central American Initiative (CAI) development efforts acknowledge that attainment of broad-based development in Central America will continue to require a long-term commitment of outside assistance.

U.S. Efforts to Attain Broad-Based Development

The CAI objective of attaining broad-based development posed a new challenge for the U.S. government agencies involved in translating this goal into specific programs and activities. Prior U.S. government efforts to promote development in Central America sought either to promote macroeconomic growth or to directly address the most pressing needs of the very poor. For the first time, the U.S. government sought to generate economic growth and, at the same time, ensure that this growth materially improved the standard of living of the poor. The U.S. government translated this goal into specific programs aimed at (1) improving the development of human resources through the provision of social services, which was considered essential to enabling the poor to take advantage of economic growth, and (2) strengthening the ability of the region's private sectors to generate jobs and income opportunities, which were seen as the tangible benefits of growth.

Agencies involved in the development aspects of CAI include AID, the Peace Corps, Department of State, and Department of Agriculture (through its involvement in commodity assistance programs). As shown on in table 5.1, the United States has devoted substantial resources over the past 8 years to improving living conditions in Central America. U.S. assistance efforts have focused on El Salvador, Honduras, and Guatemala, which are among the poorest countries in the region, to a lesser

¹The United States does not directly control the programming of local currency funds, which belong to the beneficiary governments. However, the U.S. and beneficiary governments come to a joint understanding regarding the use of local currency funds generated from the sale of commodities, as stipulated in an agreement governing the provision of the commodities. The U.S. government also works closely with beneficiary governments in the programming of ESF local currency funds to encourage them to use these funds to further the objectives of U.S. assistance efforts.

extent on Belize, which as a former British colony is not a major recipient of U.S. aid, and on Costa Rica, which historically has had a strong social service system and the most advanced economy in the region. Virtually no development aid was provided to either Nicaragua or Panama, both of which have experienced a deterioration in living standards due, at least in part, to U.S. economic sanctions and other policies.

Table 5.1: U.S. Assistance to Promote Development in Central America

	Fiscal year		
	1981-84	1985-88	1981-88
Development Assistance ^a	\$500.0	\$1,508.4	\$2,008.4
Local Currency ^b	1,268.6	1,077.2	2,345.8
ESF Project Aid ^a	60.3	171.2	231.5
P.L. 480 (title II) ^c	76.7	95.5	172.2
Section 416 ^c	0.0	69.6	69.6
Peace Corps ^d	30.5	56.6 ^e	87.1
Inter-American Foundation ^f	10.8	19.2	30.0
Total	\$1,946.9	\$2,997.7	\$4,944.6

^aFunding obligations.

^bFiscal years 1983-87. Comprised of local currency "counterpart" accounts established by governments that obtain ESF assistance and funds generated by beneficiary governments from the sale of P.L. 480 title I and section 416 commodities.

^cValue of commodities shipped.

^dBudget for Central American activities.

^ePeace Corps data for fiscal year 1988 is estimated.

^fValue of grant and loan obligations. The Inter-American Foundation, a governmental corporation that provides loans to grassroots organizations throughout Latin America, has not been directly involved in implementing the CAI.

Source: Agency records.

During this period, U.S. assistance has taken several forms, and the U.S. government has initiated numerous programs to improve living standards in Central America. U.S. efforts to improve the delivery of social services, which involve strengthening government institutions and assisting private sector organizations to augment government efforts, have focused on programs to reduce infant mortality, increase primary school enrollments, increase access to shelter, extend water and sanitation services to additional households, and increase use of family planning. In addition, the United States has initiated a wide variety of programs to address other development problems, such as improving the

quality of education (for example, through the local development of primary school text books and a bilingual education program in Guatemala), reducing malnutrition, strengthening protection of the environment (for example, by reducing the rate of deforestation), and improving infrastructure. The United States has also sought to help Central American private sectors to generate jobs and income opportunities through programs to (1) help improve small farm incomes and productivity;² (2) promote foreign and local direct investment in production, processing, and assembly facilities that produce for export; and (3) promote the growth of “microenterprises”—defined by the World Bank as firms with fewer than 10 workers and less than \$10,000 in capital—which generally operate outside the formal economy and produce largely for local consumption.

While progress in certain areas has been substantial, the level of progress anticipated by the Kissinger Commission has not been achieved. Recognizing that improved delivery of social services is essential to enable the poor to benefit from economic growth, the Commission established certain goals in this area for the 1980s. These goals, which the Commission’s report characterized as “ambitious but realistic,” included the reduction of malnutrition, elimination of illiteracy, universal access to primary education, universal access to primary health care, significant reduction of infant mortality, sustained reduction in population growth rates, and significant improvement in housing. The CAI translated these goals into the following priority objectives: increasing primary school enrollments to 95 percent by 1989, reducing infant mortality to 55 deaths per 1,000 live births by 1990, increasing availability of water supply and sewerage services by 25 percent by 1990, providing family planning services to an additional 600,000 users by 1990, increasing the rate of low-income housing by 25 percent by 1989, and increasing access to land.

The United States has made progress toward attaining certain CAI goals. U.S. efforts have already helped to reduce the infant mortality rate from approximately 86 deaths per 1,000 live births in 1983 to 53 deaths per 1,000 live births in 1986. Through its efforts, the United States has also assisted in increasing access to land, especially in El Salvador, and anticipates meeting its family planning goals. Progress toward attaining other CAI goals has been less than anticipated. The United States helped

²Through land titling efforts, support for land distribution efforts, the provision of credit, assistance in growing nontraditional cash crops (e.g., fruits, vegetables, and cut flowers), construction of farm-to-market roads, transfer of appropriate technology and land management techniques, and assistance in the development of marketing channels through which farmers can bring their crops to consumers.

to increase primary school enrollments from 86.4 percent of the primary-school age population in 1983 to 90.4 percent in 1987 but anticipates falling short of the goal of 95-percent gross enrollment. The United States has also made progress in extending water and sanitation services to the region but does not anticipate fully attaining this CAI objective in any country. It appears from existing data that the objective of increasing low-cost housing also will not be attained.

Recognizing that economic growth is needed for job creation, the Commission anticipated that attainment of its development goals would require a 3-percent rate of growth in per capita Gross Domestic Product (GDP) during 1985-90. The Commission's report stated that

"the people of the region must perceive a reasonable prospect that, with sustained effort on their part, they can achieve 1980 levels of economic activity by no later than 1990...."

The CAI established a goal of 6-percent annual GDP growth by 1990 and a job creation goal of 250,000 jobs annually. This GDP growth objective was revised in 1987 to 5- to 6-percent growth by 1992. While U.S. assistance has been instrumental in ending the region's downward economic spiral, regional economic growth has been disappointing. It now appears that none of the countries that has been the focus of U.S. assistance will attain either of the goals established by the Commission, and unless there are major increases in prices for the region's major exports and a reduction in political instability, these countries also will not attain the 1992 CAI objectives. Existing information indicates that, as a result, despite extensive U.S. efforts to generate employment, job creation has fallen far short of the CAI target of 250,000 new jobs annually. Nevertheless, the trend appears to be upward; annual job creation in the countries that have been the focus of U.S. assistance efforts increased from 76,000 during 1981-83 to 122,000 during 1984-86.

Several factors have hampered progress toward attaining broad-based development in Central America. First, the Commission's expectations were based on an unrealistic assessment of the security situation in the region. Contrary to the Commission's assessment of the prospects for peace in Central America, regional violence and instability did not cease by the end of 1985. The continuing armed conflicts, particularly in El Salvador and Guatemala, have slowed progress toward broad-based development by worsening living conditions for some Central Americans, creating a disincentive for investment, swelling the ranks of displaced persons and refugees, and damaging infrastructure. Because of

the continuing violence, the United States may have had to use scarce influence in some countries to obtain support for regional security strategies, rather than implementation of reforms needed for economic growth and development.

Similarly, the Commission's report made unrealistic assumptions regarding the factors affecting the region's overall economic growth, especially the extent of foreign exchange earnings and capital inflows. The levels of foreign exchange earnings have been lower than anticipated due largely to depressed prices for the region's major exports, which have been less favorable than even the modest CAI expectations. In addition, the \$24 billion in capital inflows (including \$8.4 billion to be provided by the U.S. government) anticipated by the Commission has also not materialized. While AID considered this figure far too high, the CAI presumed a significant repatriation of capital sent abroad earlier and/or an upsurge in private investment and lending from other donors. U.S. government funding for the CAI fell significantly short of original projections. According to AID estimates for 1980-87,³ there has been a cessation of capital flight from the region and some repatriation of capital; short-term capital flows rebounded from a net outflow of \$1.7 billion during 1980-83 to a net inflow of about \$182 million during 1984-87. However, direct and medium- and long-term investment into Central America actually decreased from \$554 million in 1980-83 to \$515 million during 1984-87. AID projects total private capital flows to Central America during 1988 at \$337 million, which may represent the beginning of a positive trend. According to AID, flows from other official donors did not begin to materialize until the late 1980s.³

As a result, Central American countries could devote fewer resources than expected to economic growth. The lack of economic growth, which helps to cushion the impact of the austerity measures needed for macroeconomic stabilization and structural adjustment, has made it more difficult for countries to institute needed economic reforms and has resulted in lowered living standards for those adversely affected by implemented reforms. In addition, the need for the United States to continue to focus the use of conditionality on implementation of macroeconomic reforms lessened the leverage that could be used to obtain reforms needed for broad-based development.

We also found that several other factors hindered attainment of U.S. development objectives. U.S. efforts to improve the delivery of social

³Estimates are for Costa Rica, El Salvador, Guatemala, and Honduras.

services have been impeded by (1) the limited absorptive capacity (that is, the ability to use outside funding effectively) of Central American governments, except in Costa Rica; (2) the low priority these governments sometimes place on providing services to the poor; (3) corruption; (4) the failure of these governments to initiate institutional and policy reforms needed to strengthen their ability to use outside funding and deliver social services; and (5) natural disasters, particularly the 1986 earthquake in El Salvador.

U.S. efforts to increase small farm incomes and productivity have been hindered by the large number of rural poor who are landless or have parcels of land that are too small to serve as viable economic units. Central American governments for the most part lack the resources and, in some cases, the political ability to rectify this serious problem, which involves not only redistributing land but also relocating families, providing financing and technical assistance, and building roads and other infrastructure to new farming communities. Efforts to generate direct investment in export-oriented enterprises have been hampered by foreign trade barriers and the failure of certain Central American governments to implement initiatives needed to increase investment, such as improving infrastructure and facilitating new business registration procedures.

Endeavors to promote microenterprise development have been hampered by the governments' new-business registration and tax and labor policies, which stunt the growth of these firms by burdening them with unmanageable costs and regulatory requirements. Microenterprises, which comprise the large majority of firms in Central America, take many forms; while sidewalk vendors are the most visible microenterprises in Central America, these enterprises also include larger operations such as small shoe factories, pottery cooperatives, wood working firms, and bakeries. Microenterprises generally operate in the "informal sector," that is, outside the legal economy. As a result, they do not pay business taxes or comply with labor requirements. Recognizing their important contributions to employment, governments permit them to operate in this manner as long as they remain small but generally require them to enter the formal economy once they reach a certain size. Many firms capable of such growth, however, are unable to comply with government registration requirements, which often require visits to scores of offices over a period of months. In addition, once becoming formal, former microenterprises are often unable to comply with government tax and labor requirements, which can exceed the financial and

administrative capabilities of these firms. As a result, they choose not to grow but to remain microenterprises.

The need for managers of the U.S. aid program to comply with certain administrative requirements appears to be complicating implementation of the overall development effort. AID officials expressed concern about legislative earmarks and functional accounts that limited AID's flexibility in allocating funds where they were most needed. For example, statutory requirements that education funds be earmarked for primary education has limited the ability of the AID mission in Honduras to devote sufficient resources to vocational training, which AID managers considered to be a high priority component of its overall strategy to attract investment. Agency officials also stated that "buy American" provisions often prohibit beneficiaries from purchasing less expensive foreign-made goods that meet their needs. The paperwork involved in obtaining exemptions from this requirement often delays procurements. For instance, one AID program manager expressed concern that "buy American" requirements made it difficult for beneficiaries of U.S. private-sector development efforts to purchase needed machinery produced in other countries. In addition, AID officials explained that the use of local currency funds has been complicated by agency determinations requiring beneficiary governments to play a larger role in jointly programming these funds with the AID missions. For instance, in one country, AID needed to establish a bipartite commission comprised of AID and host-government officials to make determinations on programming local currency funds. Since the host government officials were Cabinet officers, the commission has reportedly experienced difficulty convening, and its decisions have taken on political overtones that hinder the process.

Outlook for Development

Participants at our San Jose and Washington conferences concluded that the United States needs to maximize the impact of its assistance to improve living conditions for poor Central Americans by increasing the emphasis placed on attaining broad-based development objectives. Our analysis indicates that, unless greater progress is made in improving living conditions for the poor, the United States may face a situation in which unfulfilled expectations cause poor Central Americans to turn against the United States and reject U.S.-supported democratic governments in the region. Yet the continuing regional conflicts (including political violence) and economic difficulties would undermine any effort to substantially accelerate progress toward development. Thus, to implement this change, the United States first needs to help Central

America attain at least short-term regional stability (including substantially reduced political violence) and make greater progress toward attaining macroeconomic stabilization and adjustment, both of which are needed for an accelerated development effort to be sustainable.

Placing greater emphasis on broad-based development would entail (1) shifting funds from balance-of-payments support to development assistance in countries that attain stabilization and make progress toward adjustment and (2) focusing the use of U.S. influence and program conditionality in such countries to encourage reforms needed to "spread the benefits" of economic growth. During this process, those Central American countries that have been the focus of U.S. assistance efforts most likely will require outside assistance at least commensurate with that provided by the United States under CAI. If the United States normalizes relations with the governments of Nicaragua and Panama, they will most likely seek reconstruction assistance from the United States. The February 1989 report of the International Commission for Central American Recovery and Development, better known as the Sanford Commission, projected that approximately \$10 billion in external assistance will be required over the next 5 years to promote recovery and establish a basis for sustained social and economic development in Central America.

Maintaining this level of support will require continued high levels of assistance to the region from the United States, other donor nations, and the multilateral development banks. While external assistance to the region did not reach levels anticipated by the Kissinger Commission, other donor countries, most notably Japan and certain European nations, have begun to increase their assistance to Central America during the late 1980s. In addition, multilateral development agencies have been involved in promoting economic growth in certain countries. Central American countries themselves must also strengthen their commitment to promote the development of their own poor.

There was general agreement at both GAO conferences that the U.S. development strategy should continue to strengthen the provision and delivery of social services and focus on the creation of jobs and income opportunities. Our conference participants agreed that improved social services were essential; they represent the human-resource development efforts needed to prepare the poor to participate in economic growth. Available statistics demonstrate that microenterprises and small farmers, which comprise the small-business communities of Central American countries, are best capable of using U.S. funding and technical

assistance to create jobs and income opportunities for the poor. Supporters add that promoting the growth of microenterprises also serves a democratization purpose by helping to create a domestic entrepreneurial class that is the beginning of a middle class and a "political center." This new middle class, in the long run, can support U.S. government efforts to encourage Central American governments to make the changes needed to improve the delivery of social services and secure the growth of the domestic business community. Even though the facilities created through export-led growth tend to be relatively less labor intensive when compared with microenterprises and small farms, most observers agree that programs to promote investment in export industries can also generate needed jobs and foreign exchange.

Conclusions and Matters for Congressional Consideration

As part of this new emphasis, the U.S. government may want to (1) acknowledge that attainment of broad-based development will require a long-term effort, (2) reaffirm its commitment to help Central America see this effort through to its completion, and (3) place greater emphasis on coordinating its development efforts with other donors. Specifically, as a country stabilizes its economy and makes progress toward adjustment, the United States may want to consider shifting some ESF funds to development projects and encouraging international institutions to shoulder the major burden of furthering structural adjustment.

Our analysis indicates that the United States needs to continue certain efforts and strengthen others as it pursues its development efforts in Central America. Specifically, the United States can improve the delivery of social services by

- making greater use of conditionality, possibly in coordination with other donors, to encourage Central American governments to initiate institutional and policy reforms, such as (1) revising labor management practices and tax policies needed to increase absorptive capacity, (2) refocusing priorities to better reflect the needs of the majority of their people, and (3) reducing corruption, and
- continuing to use private organizations to augment government delivery of social services and, where appropriate, strengthening the role played by municipalities in providing such services.

The United States can assist the development of small farms and microenterprises by

- helping to increase farm incomes by devoting greater resources and, where appropriate, making greater use of conditionality to support and encourage government and private efforts to redistribute land to poor farmers, possibly through special banks that provide mortgages for this purpose, and by expanding efforts to provide small farmers with credit and technical assistance and
- assisting the development of microenterprises by increasing credit and technical assistance, using conditionality to encourage Central American governments to implement administrative reforms, such as simplifying new business registration practices and insulating small firms from certain tax requirements and labor regulations and enhancing their efforts to find ways for the larger export-oriented firms to obtain services and supplies from domestic microenterprises.

The United States can assist Central American countries in promoting foreign and local direct investment in export-oriented enterprises by

- making greater use of conditionality to encourage beneficiary governments to make policy and institutional changes, such as increasing investment in infrastructure and improving business services, which are needed to generate greater levels of investment;
- working with the Central American countries to increase intra-regional trade, possibly by recreating a regional economic community similar to the Central American Common Market, which would require ending the political isolation of Nicaragua and helping the member states to take measures needed to better orient their economies to participate competitively in world markets; and
- continuing favored access to the U.S. market.

Agency Comments

AID did not express any disagreements with the overall findings, conclusions, and matters for consideration contained in this chapter. It made specific comments regarding the level of investment in Central America and the difficulties involved in recreating the CACM. We took these comments into consideration and revised the draft accordingly. AID's comments and our response are included in appendix IV.

GAO Conference on Central America, Washington, D.C.

On January 12 and 13, 1989, we hosted a conference of U.S. experts on Central America in Washington, D.C. The purpose was to (1) evaluate our tentative review findings on the impact of U.S. programs promoting security, democracy, economic stabilization, and development; (2) obtain additional insight into the effectiveness of U.S. strategies to achieve these goals; and (3) provide a forum for the free exchange of ideas on the future direction of U.S. approaches to the region's problems. About 25 panelists were invited for a full day of working group sessions and a half-day of plenary discussions with an invited audience.

The panel, which included academicians, current and former U.S. government officials, and representatives of nongovernment entities, was divided into two groups: one focused on political/security-related issues, and the other focused on economic/development-related issues. The conference included in-depth discussion among all panelists and interaction from an invited audience of congressional staff, academicians, and government and nongovernment officials. Dr. Mark B. Rosenberg, Director, Latin American and Caribbean Center, Florida International University, led the political/security discussions. Dr. Marc Lindenberg, Lecturer in Public Policy, John F. Kennedy School of Government, Harvard University, led the economic/development discussions.

Summary reports on the proceedings of the panels follow. The views and opinions in these summaries reflect those expressed by the participants and, therefore, do not necessarily represent those of GAO.

Regional Security

Discussions about U.S. efforts to improve security and defense relations in Central America focused on strategic, regional, and tactical concerns.

Strategic Concerns: The Soviet Role

A major issue confronting the panelists was the current nature of the Soviet strategic threat, given perestroika and glasnost. Throughout the discussion, a number of panelists indicated that the United States had never formally raised the issue of Central America with the Soviets. The current Soviet transition offers an important opportunity to raise this issue and convince the Soviets to reduce their support for Nicaragua (and, by implication, Cuba). However, some were skeptical that any U.S.-Soviet agreement would have an impact on Cuba's more revolutionary communist foreign policy toward Central America.

Regional Concerns:
Broader U.S. Role

Panelists emphasized their sense that bipartisanship on regional security issues was essential if coherent bilateral and multilateral efforts were to be presented. They perceived threats to regional security to be broader than the Soviet role. They believed, for example, that narcotics trafficking, the Central American military, and economic instability constitute significant threats to the national security of Central American countries.

Panelists differed on what actual U.S. regional security objectives had been during the past 8 years: containment of communist expansion or rollback. One panelist suggested that an evaluation of the effectiveness of U.S. policies was contingent upon which of the two was the major U.S. objective.

While the group perceived the threat to regional security from Cuba to be greater than from Nicaragua, several panelists agreed that the United States had to deal directly with Nicaragua to address U.S. security concerns. But to the extent that Soviet influence in Nicaragua is the major issue for U.S. security, there seemed to be a sense that the Soviet Union would have to play a role in the process.

Tactical Concerns: Revised
U.S. Role

Panelists tended to be critical of U.S. regional security efforts, particularly regarding Nicaragua and El Salvador. In general, this concern focused on U.S. support for a low intensity conflict strategy, including its costs and impact. On Nicaragua, there was a feeling that further isolation would be a mistake in that its reliance on the Soviet Union would be enhanced and the possibility for Central American economic recovery would be further reduced. One panelist asserted that the more pressure placed on Nicaragua by the United States, the greater its dependence on the Soviet Union and other Eastern European countries becomes. Another panelist asserted that isolating Nicaragua from Central America is "maniacal" because the Nicaraguans who should be in Nicaragua's political mainstream are not even in Nicaragua.

On El Salvador, concern was expressed about the nature of the conflict there and the military aspects of low intensity warfare. U.S. tactics were seen to be exhausted; however, the panelists were without suggestions as to how to deal with the guerrilla warfare and terrorism being waged by the left.

In conclusion, one panelist suggested that the United States should have taken fuller advantage of the security-related provisions of the Esquipulas II peace agreement.

Strengthening Democracy

Discussions about U.S. efforts to strengthen democracy in Central America during the past 8 years focused on the philosophy of U.S. support for democracy initiatives in Central America, accomplishments of these initiatives, and the merits of various U.S. approaches.

The Philosophy of U.S. Support

Should the United States be promoting democracy overseas? Can democracy be exported? Panelists raised these two fundamental questions. They seemed to agree that, because the entire region is experiencing a new wave of democracy, the United States should be involved in supporting democracy and should emphasize its importance in bilateral affairs.

One panelist stated that the United States should not be ashamed about promoting democracy in Central America but noted that the United States does not have a monopoly on things democratic. Another panelist with experience in the executive branch pointed out that the United States can facilitate, assist, and promote democracy but cannot impose it on the region. Another asserted the importance of continuity in the U.S. approach to democracy. However, another cautioned that the American thrust for democracy contradicts the Latin American desire for nonintervention.

In enumerating key elements of democracy, the group believed that peace and democracy were intimately related. Without one, the other cannot exist. An emphasis was also placed on democracy's procedural quality—accountability, empowerment, and an absence of the government's tyranny over the people. Panelists were less concerned about the institutional configuration of democracy. However, one panelist reminded the group of Central America's rich plurality of private institutions, which ultimately serves as the solid basis for any democracy.

Limited Progress for Democracy in Central America

The general sense of the panelists was that more time was needed for the significant development of democracy in the region. One panelist suggested that the democratically elected governments seem to behave in exactly the same way as the undemocratic governments. Although one panelist noted the lack of indicators to measure the qualitative and

quantitative changes in the region's democracies, several felt that positive democratic changes had taken place since the early 1980s. Another panelist asserted that the reinforcing nature of positive changes in the region, large or small, should not be underestimated.

Civil-military relations still constitute a major area of difficulty in promoting democracy. One panelist stated that the military involvement in Central America "diminished" the quality of democracy. Another asserted that the military makes the key decisions in every country in Central America and that, accordingly, the current state is something other than real democracy. Another panelist further pointed out that U.S. policies have often encouraged a strong military role. As a result, efforts to support democracy have been undercut.

Approaches to Strengthening Democracy

It was generally agreed that if U.S. programs are to be continued, higher levels of funding will be needed. However, there was no agreement about the types of programs that should be conducted. One panelist suggested that the United States should channel more of its assistance through intermediaries to avoid involvement in sensitive activities.

While there was little evaluation of the specific instruments and policy tools that could be used, one panelist suggested that the United States should look at the component parts of what constitutes a democratic process and then reinforce those areas where there are opportunities for progressive change. In response to the problem of military influence in the region, another panelist indicated that the United States should condition its aid on actions that would increase the power of the civilian sector over the military sector; otherwise, in his opinion, democracy could not progress.

While one panelist asserted that Latin American cooperation could be an important instrument to support the region's democracies, he pointed to an existing multilateral arrangement—the Esquipulas II regional peace plan—as the most important instrument to enhance democracy in Central America.

Panel Recommendations on Regional Security and Democracy

The following approaches and recommendations emerged from the political/security discussions.

1. For U.S. efforts to have greater impact in Central America, a bipartisan consensus on policy must be forged in Washington. This consensus

should focus on more realistic objectives and expectations that define the nature of the security threat and agreement on the roles and means to meet that threat.

2. The United States should not base its regional policies on what the Soviet Union has said it will do in other areas of the world. Rather, there should be direct communication between the two countries over security-related matters. Small, cautious steps with Cuba might be undertaken to broaden the dialogue on Central America. The United States should directly communicate to Nicaragua its concerns on security matters and attempt to foster a mutually acceptable understanding.

3. The United States should rebuild its consultations and communications with major Latin American countries as a means to promote a broader multilateral effort to resolve Central America's problems. Central American countries themselves should play a larger role in the resolution of their own problems. Any peace settlement for the region must involve Nicaragua, which should not be further isolated from other Central American countries. Esquipulas II, with enhanced verification mechanisms, constitutes a vehicle for addressing U.S. political and security concerns.

4. Democracy is the best way to guarantee U.S. security interests in Central America. The United States and other Western allies should develop a detailed plan for strengthening democracy in the region. U.S. development assistance efforts should be more sensitized to the significance of democracy. Institutional adjustments should be made, higher levels of funding should be allocated, more interagency consultation should be promoted, and in-country missions should have specially designated and trained officers responsible for overseeing democratization programs.

Economic Stabilization

The panel believed that the Central American economic crisis had been reversed in many countries. But the group's opinions differed about how profound this reversal was and why it took place. Part of the group saw the turnaround as fragile, even in countries like Costa Rica and Guatemala, while others felt it was more solid than in most Latin American countries in the 1980s. Part of the group saw U.S. policy and assistance as vital to this turnaround; others noted that some Central American governments, like that of Guatemala, took the initiative before other donors expressed interest. Some of the group felt that the importance of other donors in the turnaround should not be overlooked.

The panel saw economic stabilization as most successful in Costa Rica, Guatemala, and Belize; as less successful in Honduras; and as unsuccessful in El Salvador, Panama, and Nicaragua. All agreed that significant debt relief for Costa Rica will be necessary if future economic progress is to take place. The group also highlighted rural development in Guatemala as an important future emphasis. The group agreed that U.S. policymakers should squarely face the tradeoff between the goal of economic policy reform needed to consolidate economic recovery in El Salvador and Honduras and political and military objectives.

If political and military objectives are primary, then the process of economic policy reform may have to be slower. The group reached no consensus about the impact of U.S. sanctions on Nicaragua and whether they should be lifted.

Debt

The panelists considered that the debt problem was not as important for the Central American countries as for their larger Latin American neighbors such as Brazil, Mexico, or Argentina. However, they believed it was important to differentiate the problem by country and source. Costa Rica and Nicaragua have serious problems that require a special focus. The group recommended the use of multidonor consultative groups to review specific country situations with key officials from those countries. These discussions could include mechanisms to lighten the debt burden, particularly for Costa Rica and Nicaragua.

Improving the Standard of Living

The panel group agreed that because of the seriousness of the economic collapse in Central America, donors paid more attention to stabilization than to broad-based development. However, they saw some successes in specific development areas.

Land Reform

The panelists believed that U.S. policymakers needed to place Central American land reform in the context of world experience. One panel member emphasized that land reform efforts generally did not work on a gradual basis. The most successful efforts, as in Japan and Taiwan, were rapid. The panelists acknowledged some success in El Salvador's effort and encouraged policymakers to reconsider the role of land reform as a basis for providing more stable social development.

Social Service Delivery

The panelists believed it was important to strengthen Central American institutions to improve their capacity to provide social services. They would encourage policymakers to reconsider the role of municipal development and the role of private voluntary organizations, the private sector, and units of government in delivering critical social services. They specifically would discourage U.S. policymakers from using the military for the delivery of social services.

Export-Led Growth

The panel group believed that Costa Rica, Guatemala, and Honduras had demonstrated encouraging changes in their export sectors. In the first two countries, in particular, there have been increases in nontraditional exports such as fresh fruit and vegetables, flowers, shrimp, lobster, fish products, and some light manufactured products. There were differing opinions about how long-lasting these changes would be and how much future growth and employment could be generated from them. The panelists stressed the need to open the U.S. market to Central American products even further and to help the Central Americans find markets in Europe and Japan. There was no consensus about the role of regionalism or the Central American Common Market in future economic growth.

Microenterprise
Development

The panelists gave high marks to U.S. assistance in this area. It reinforced the importance of assistance to microenterprises and the informal sector. They noted the difficulties involved with linking microenterprises and small businesses to export development and suggested that U.S. policymakers look at lessons learned in micro-enterprise development elsewhere.

Conclusions and
Considerations for the
Future

The following approaches and conclusions emerged from the discussions about U.S. efforts to support economic stabilization and development:

1. Economic stabilization efforts were relatively more successful in Costa Rica, Guatemala, Honduras, and Belize and quite unsuccessful in El Salvador, Panama, and Nicaragua. Because of the depth of the economic and political crises in the region, development goals were not met. Neither growth nor employment goals were met due to unrealistic time frames in the initial assistance proposals, political violence, limited absorptive capacity of the governments and private institutions, lack of interest and commitment to policy reform in some countries, and problems in the international economy.

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Susan Kaufman Purcell
Vice President of Latin American Affairs
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As a result of these factors, per capita income and the standard of living in Central America actually deteriorated during the 1980s in spite of large amounts of U.S. assistance. The panelists disagreed about the depth of the reduction in living standard levels among Central Americans and about the extent to which U.S. assistance might have helped the situation.

2. The objectives of U.S. assistance for the future should be reformulated to focus much more specifically on adjustment with more broadly based economic and social development. This approach should include an explicit focus on export-led growth with special attention to employment and improved standards of living, more multilateral coordination of foreign assistance efforts, and stronger reinforcement of Central American initiatives, particularly those based on regionalism. Also, more attention is needed on policy differentiation by country, since each of the Central American nations has had a different level of economic recovery in recent years. The panelists also encouraged U.S. policy considerations in areas like the environment, infrastructure development, municipal development, and the protection of high-risk poverty groups.
3. Panelists favored a renewed emphasis on specific sectors, such as agriculture and industry, as well as an effort by the U.S. government to help Central American countries negotiate with the International Monetary Fund and the World Bank to extend the time frames for economic stabilization and structural adjustment.
4. The original time frame for U.S. initiatives for Central American democracy, peace, and development proposed by the Reagan administration was too short to have the desired impact on economic recovery and broad-based development. The time frame should be extended for a consolidated and solid foundation.

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GAO Symposium of Central Americans, San Jose, Costa Rica

On August 11 and 12, 1988, we sponsored a symposium in San Jose, Costa Rica, to obtain the views of about 30 Central Americans on the impact of U.S. assistance to the region during the 1980s. Participants were asked to assess the results of U.S. assistance to achieve economic stabilization, improve the standard of living, strengthen democracy, and reduce Soviet bloc influence. We felt that a symposium of this type would gather views of segments that might not be obtained during the course of in-country work, specifically those whose views might not necessarily be supportive of U.S. activities but whose background qualified them to address at least one of the issues under consideration. Symposium participants included academicians; current and former government officials associated with development, planning, finance, and economics; and representatives of political parties from the five Central American countries and Panama. The symposium was organized jointly by GAO, the Central American Institute for Public Administration, and the Latin American Faculty of Social Sciences.

Summary reports on the proceedings of the symposium follow. The views and opinions in these summaries reflect those expressed by the participants and, therefore, do not necessarily represent those of GAO.

Reducing Soviet Bloc Influence

Overall, participants agreed that the U.S. policy of reducing Soviet/Cuban influence in Central America has been "erratic, confusing, and highly politicized" and has provoked uncertainty about U.S. objectives in the region. They agreed that U.S. policy favors regional armament and therefore limits the possibilities of reaching an agreement on military reductions. The majority felt that U.S. policy is based on the concept that violence in Central America has its basis in communism and international Marxist subversion. They consistently stated that the United States had elevated the conflict from an internal to an external level and, as a result, Central America had entered the East-West conflict. Such a policy, they said, ignores secular and oppressive social injustice—the true cause of the conflict.

In the case of El Salvador, participants agreed that the United States has addressed the effects rather than the causes of the conflict and that focusing on the former only intensified the war and created other negative effects. They said that undue U.S. military intervention in the region drove some governments and insurgent groups to request more military assistance from Cuba and the Soviet bloc. To Central Americans, U.S. influence is just as worrisome as Soviet/Cuban influence in that any manifestation of the East-West confrontation in the region

adversely affects the national interests of Central American countries and their sovereignty.

There was a broad consensus that the type and amount of U.S. military assistance to the region has had negative results. For example, in El Salvador, participants agreed that the conflict between the U.S.-supported military and the leftist insurgency has decreased the prestige of the civilian government due to its inability to solve the conflict. They added that large amounts of U.S. assistance resulted in dependence on those funds as well as widespread corruption. In Nicaragua, the conflict waged between the contras and the Nicaraguan military has exacerbated the economic and social situation without resulting in the intended democratization of the Nicaraguan government. Overall, participants stated that continued military assistance to Central American armed forces only reinforces the autocratic nature and tradition of the military.

Participants strongly favored negotiated solutions to the regional conflicts. They believe that a peaceful solution would be more realistic in the context of regional agreements and would promote respect for the sovereignty of Central American countries. They noted that although the Esquipulas II regional peace plan addresses security issues and establishes that Central American governments negotiate the limits of foreign military presence in the region, U.S. policy and intervention have postponed action on security-related provisions. Participants emphasized that the United States must accept a regional disarmament plan that reflects the political interests of each Central American country with input from the United States. Many participants suggested that the United States should sign agreements with the Soviet Union and Cuba to reduce arms or achieve relative disarmament in the region. They added that the United States must realize that regional violence has its origins in a tradition of social injustice and ensuing internal conflicts, not "superpower" conflicts. With this recognition, the United States should address the true causes of the region's problems—economic, social, and political disparities. Regarding the role of the military in a democratic government, participants agreed that civilian leaders must assign a subordinated role to the armed forces and suggested that the United States could work with these governments to strengthen their capabilities to manage their armed forces.

Strengthening Democracy

Many participants felt that (1) the goals and long-term implications of democratization initiatives sponsored by the United States have not been clearly stated and (2) it is unclear whether the United States is genuinely committed to promoting democracy or is simply protecting its own security interests. Some felt that in the case of Nicaragua, for example, the United States is more interested in preventing Marxism from spreading throughout the region (and thus posing a potential security threat) than it is in promoting democracy. They added that if the United States is committed to promoting democracy, its strategy should be implemented in a development context.

The majority of the participants believe that the United States is trying to impose its own style of democracy on Central American nations without recognizing individual country differences or national interests. For example, some stated that the United States is imposing its own brand of democracy in El Salvador through military means; they emphasized that military repression and human rights abuses, which they believe continue, contradict the basic tenets of democracy. Further, in some instances, no national consensus on democracy exists. At the same time, they believe an imposition of foreign will denies the autonomy of a country, and the less autonomy a country has, the more difficult it becomes to build a true democratic process. They added that Central American governments accept whatever democratization initiatives the United States recommends without a clear understanding of where the actions will take them. However, this assistance is conditioned on factors that are sometimes beyond the control of civilian governments, such as human rights violations.

According to many symposium participants, the United States has emphasized military solutions to the conflicts in Central America to the detriment of dialogue and peaceful negotiations. They felt that, in reality, democracy evolves when injustices in the society are addressed, not when the military prevails over repressed elements of the society. They added that war only reinforces the inherent power of the military and suggested that the United States should accept the possibility of negotiated solutions and should comply with regional initiatives to promote peace, such as Esquipulas II.

There was a broad consensus among participants that the United States may have taken a too visible role in promoting democracy, especially in El Salvador, Nicaragua, and Panama. To avoid the appearance of undue interference, some suggested that the United States should keep a lower profile, permit Central Americans to be more involved in formulating

programs, encourage multi-donor projects, and channel sensitive democratization assistance through regional or multilateral institutions.

Economic Stabilization and Structural Adjustment

Most participants agreed that not much progress had been made to achieve economic stabilization and structural adjustment. They felt that the United States distributed economic assistance as a tool to achieve its security objectives instead of as a means to achieve long-term regional economic stabilization. They charged that U.S. aid is (1) administered according to “universal truths” that ignore individual country circumstances and (2) channelled bilaterally rather than through multilateral agencies in order to control its application. Some felt that the United States has undue influence over the International Monetary Fund, World Bank, and other multilateral organizations and that, as a result, these organizations have policies to emphasize short-term stabilization policies at the expense of gradual economic development and long-term solutions. Other participants lauded the multilateral organizations for helping Central American governments realize the importance of austerity policies, which are indispensable to balanced long-term growth.

The majority of participants felt that economic malaise in the region continues due to a perceived “double policy” on the part of the United States; that is, the United States seeks to attain economic stability in some countries while destabilizing other countries. Further, they felt that it is impossible to stabilize an economy without first addressing the basic needs of the poor majority, who bear the brunt of economic instability. They recommended that the United States reevaluate its priorities for promoting economic stabilization and adjustment and suggested that the United States should be more receptive to policies developed by Central Americans or in conjunction with other organizations, such as the European Economic Community.

According to some participants, the United States places too much emphasis on privatization and on channelling development assistance through the private sector. They cautioned that the private sector in Central America is not adequately developed and, in most cases, represents the oligarchy, which is reluctant to share the benefits of economic growth. They added that the private sector lacks the capacity to define economic policies, to do business in an international context, and to implement technological change. They felt that the United States must accept that Central American governments have a role in promoting industrial development and that certain industries need government protection, especially those industries that provide public services and

do not operate at a profit, such as mass transportation industries. Most felt, however, that Central American governments are far from being perfect and cited specific miscalculations in the management of economic policy. For example, federal deficits in some countries have been increasing throughout the decade, but the governments in these countries have refused to initiate tax reforms. The governments of Costa Rica, Guatemala, and Honduras have steadfastly refused to adjust their exchange rates to reflect more realistic market valuations. Most participants agreed that the United States should work with Central American governmental institutions to improve their efficiency rather than press for privatization.

Some participants called on the United States to take a different approach in helping Central Americans export their goods. Central American countries currently depend on a few exportable products and a rigid exporting structure. They recommended that the United States break down existing barriers and open its markets selectively to Central American products. They cautioned that market openings should be selective to avoid deterioration of exchange rates and that the United States should also help countries compete in international markets. Some predicted future problems arising from biotechnological developments in industrialized countries, warning that they are producing substitute products for Central American agricultural exports.

Improving the Standard of Living

According to the majority of symposium participants, the United States focused its efforts on solving the region's problems by promoting procedural rather than substantive democracy and ending the conflicts militarily rather than addressing the social, economic, and political causes of insurgencies. They believe that Central Americans' living conditions deteriorated drastically during the 1980s as a result of the U.S. approach and Central American governments' reluctance to initiate necessary reforms. Further, because development assistance was not channeled effectively or efficiently and structural changes, such as agrarian and tax reform, and technical assistance to promote self-sufficiency were not implemented, improvements could not take place.

According to the participants, deterioration in the standard of living across Central America has reached intolerable levels. They agreed that it is impossible to address social development within the context of war. Many pointed out that U.S. efforts have not alleviated poverty in Central America because formal structures through which aid is channeled, such as the private sector, prevent the aid from reaching the poor. In

addition, some pointed out that systems of taxation and distribution of public sector spending are counterproductive in that taxes are not equitably levied and public goods are unfairly distributed. Others raised the serious problem of agricultural credit provided to farmers at very high interest rates. Still other participants criticized the U.S. food aid program, stating that it obstructs the productive processes by oversupplying sectors of the agricultural economy with food and results in unfair competition for local producers. They suggested that to eradicate poverty in the region, the United States and the oligarchies must take risks in supporting political, economic, and structural adjustments.

Participants agreed that the United States should not use its agrarian reform program to further its security goals but should establish production systems that promote self-sufficiency, provide agricultural credit, and enhance technical and marketing skills. They said that organizations helping to alleviate poverty require increased technical assistance in order to help the populations overcome the problems of nutrition, housing, health, and others. Participants added that Central American countries have been developing their own mechanisms to channel aid to grassroots organizations but that they require additional resources to channel that aid effectively and efficiently. Many endorsed the recommendation that the United States increase governments' control and accountability over ESF assistance, alleging that ESF monies had been used to fund military activities.

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Former Vice Minister of Economics

Mariano Castro Moran

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Director of Research

GAO Workshop on Panama, Washington, D.C.

Although linked by geography and recent history to the rest of Central America, Panama's political and social traditions are very distinct, and its large export-oriented service sector is unlike that of the rest of the region. These factors, combined with the history of the Canal and the continuing strong U.S. military and commercial presence, have created a unique relationship between Panama and the United States. Strategically, Panama facilitates the projection of U.S. interests in this vital part of the world.

The Panama Canal Treaties of 1977 marked the end of one phase of U.S.-Panamanian relations and the beginning of another. While U.S.-Panamanian relations have not always been warm, recent events have strained this relationship and highlighted the difficulties faced by the United States in Central America.

We invited six experts on Panama to review events preceding the political and economic crisis of 1988-89 and to explore possible U.S. options concerning U.S.-Panamanian relations. These experts included representatives of the business community and academia and representatives from the Department of State, the National Defense University, and the Agency for International Development. This workshop, held on February 3, 1989, in Washington, D.C., was intended to complement our January 1989 Conference on Central America.

A summary report on the proceedings of the workshop follows. The views and opinions in this summary reflect those expressed by the participants and, therefore, do not necessarily represent those of GAO.

U.S. Assistance to Strengthen Democracy and the Panama Defense Forces Concurrently

According to participants, U.S. military assistance to the Panama Defense Forces (PDF) was aimed at forging an apolitical, professional, modern fighting force capable of fulfilling the terms of the Panama Canal Treaties, to include assuming principal responsibility for defense of the Canal in the year 2000. It provided training in the United States for younger, junior officers in the hope that they would reach responsible positions in the mid-1990s. U.S. officials tried to convince Panamanian officers both to withdraw from the political arena and to change the structure of the PDF by devolving police functions into a separate entity. In this way, it was hoped that the PDF would be insulated from the corruptive influences sometimes associated with police functions.

The Panamanians made some institutional changes, and training individual PDF officers produced some improvements. However, panelists

agreed that major institutional changes needed to complement the individual training and fully professionalize the PDF did not occur. Police functions, for example, continued to be dominated by the PDF. Panelists pointed to history and the unique structure of the Panamanian port economy as being key to understanding why these major structural changes were not made; namely, a certain amount of graft and corruption have always been tolerated by the Panamanian business community. Some panelists pointed to events of the early 1980s, including the death of General Omar Torrijos, Panama's strongman from 1968 to 1983; the conflict in Central America; and increased drug trafficking as factors that provided opportunities for corruption. The lack of a Panamanian military academy to train PDF officers was also seen as a failure of U.S. strategy, since those trained at such an academy might have more effectively set an example for the rest of the PDF. Panelists did not believe that training individual officers in the United States accomplished this.

Panelists viewed U.S. efforts to strengthen Panama's civilian sectors unaffiliated with the PDF as ineffective due to the weak and splintered nature of the civilian sectors and Torrijos legacy of military involvement in civilian affairs. Both factors resulted in an imbalance in strength between the PDF and the civilian sectors unaffiliated with the PDF.

Panelists felt that, in theory, it should be possible to strengthen both the military and civilian sectors; however, they were divided as to whether or not this could actually be done. One panelist was extremely skeptical, noting the relative lack of success of programs carried out by the United States since the 1960s. Another panelist felt that while such an approach could not work in Panama, it might be effective elsewhere and should be examined on a case-by-case basis. This view held that strengthening democratic sectors and military institutions concurrently might be especially useful in countries with powerful paramilitary forces working outside civilian government control.

The forced resignation of President Nicolas Ardito Barletta in 1985 marked a key turning point because the United States, given the opportunity to uphold an elected leader, did not do so. Panelists pointed to competing agendas among U.S. government agencies as being principally responsible for this inaction. Some panelists felt that the United States had been placed in an untenable position by accepting the election of Barletta in 1984—a candidate with no real base of power outside of the PDF. They contended that fortifying the democratic process required that we accept the results of that process.

U.S. Policy-Making Complicated by Internal and External Factors

Panelists agreed that defense of the Canal and movement toward a fully functioning democracy have been the primary long-term U.S. policy objectives in Panama. However, concurrent with these two long-term objectives were many short-term, highly visible, unstable objectives, such as the interdiction of drugs, support for U.S. security objectives in the rest of Central America, intelligence gathering and, more recently, economic support for the U.S. and Panamanian business community and sanctions designed to hurt the government and the PDF. These unstable objectives were viewed as sometimes contradictory to each other and to the long-term objectives. Some panelists pointed to the Noriega indictments, congressional pressures, and U.S. domestic politics in an election year as driving short-term U.S. policy and complicating decision-making. Although one panelist felt that administration efforts to coordinate U.S. policy were more than sufficient, most panelists felt that decision-making was complicated by the inability of the United States to prioritize U.S. interests and reconcile competing agendas among agencies.

Panelists agreed that the United States misunderstood the strength and character not just of Noriega and the PDF but also of the political opposition. The indictments against Noriega were seen as being unenforceable, and the opposition was regarded as being weak and splintered, rendering decision-making in Washington more difficult. Public posturing angered Noriega, raised expectations for a quick solution, and created conditions less conducive to resolution of the crisis. Most panelists noted the lack of a greater effort to coordinate actions with friendly countries. They perceived that a unilateral U.S. effort helped Noriega and the PDF portray the conflict as one between the United States and Panama, rather than a conflict among Panamanians. Moreover, it was felt that Congress and the press downplayed important actions carried out by Latin American nations.

U.S. Economic Sanctions

The U.S. policy of imposing economic sanctions on Panama was viewed by some panelists as an example of how complex and contradictory U.S. decision-making process in Panama has been.

The United States imposed sanctions to complicate public finances and thus put pressure on Noriega to step down from power. Panelists asserted that, instead, sanctions hurt the U.S. business community and the Panamanian opposition. Some initial provisions of the sanctions may have even helped Noriega. One panelist remarked that U.S. sanctions were the most brutal ever applied.

In addition, some panelists felt that the policy-making process on sanctions may have been flawed. They pointed out that despite the very large U.S. investment in Panama, the U.S. business community was not included in the initial decision-making process on the sanctions. As a result, the sanctions had to be watered down in order to address U.S. private sector concerns. Also, some panelists felt that the United States placed too much emphasis on economic sanctions, since the effects could not be confined to the targeted sectors—the government and the PDF.

Issues for the Future

Participants agreed that the U.S. government should not recognize the Solis Palma regime and should stay the course—at least until after the Panamanian election in May 1989. While economic sanctions dramatically raise the cost of any future efforts to reconstruct the Panamanian economy and continued nonrecognition of the Solis Palma regime complicates the operations of the U.S. Embassy, it was felt that neither the U.S. Congress nor the public would tolerate any accommodation of an accused drug dealer. They also did not recommend tougher sanctions because, in their view, Noriega has already demonstrated his ability to survive such measures.

Panelists identified both the May 1989 elections and the 1990 submission to the U.S. Senate of a Panamanian as Administrator of the Panama Canal Commission as challenges for the United States. Of the two, the elections were considered particularly critical. At issue would be the degree of support for the opposition, the legitimacy of the elections, and whether or not to recognize the newly elected Panamanian government. The assumption was that the Noriega-backed candidate would win in an election at best only marginally flawed. Nonrecognition of the elected government in such a scenario would allow the United States to take the moral high ground in favor of democracy but might also present continuing legal problems for operation of the U.S. Embassy and continued implementation of the Panama Canal Treaties. Further, this action would isolate the United States if other nations recognize the new regime. On the other hand, recognition would simplify operations of the Embassy and allow implementation of the treaties to go forward but would damage U.S. prestige abroad and leave Noriega in his position of power. Recognizing the new regime, while at the same time treating Panama as the United States does other unfriendly governments, and downgrading the status of the chief of mission from ambassador to charge were viewed by panelists as a possible compromise. Military force was not viewed as a viable alternative, since it would endanger the lives of Americans living in Panama and negatively affect U.S. relations with

the rest of Latin America. An honest election would, of course, eliminate the need to make these difficult choices.

Participants recommended that the United States coordinate its actions more closely with those of its allies in the hemisphere and elsewhere. Actions taken by the Group of Eight were considered to be of special importance.

Similarly, participants agreed that abrogation or talk of abrogation of the Panama Canal Treaties was no solution to the crisis because it would give Noriega more ammunition with which to fuel anti-American sentiment and would push a broad spectrum of the Panamanians against the United States. In addition, it would convert what up to now has been a Panamanian-U.S. crisis into a hemispheric issue.

Instead, participants recommended that the United States explore other means to bring about economic pressure, such as changes to flags of convenience rules, and alternatives to the use of the Canal, such as a high-speed rail link across the southern United States. This would provide an incentive for Panamanian officials to resolve the crisis and give the United States greater leverage in its dealings with Panama. They pointed out that while the Canal is of increasing importance to Latin America, its commercial importance to the United States has declined and will continue to decline over time. Finally, U.S. aid for reconstructing Panama could provide an incentive for Panamanian officials to resolve the crisis.

Panelists did not think that Panama would become a client state of the Eastern bloc similar to Nicaragua. However, failure to resolve the crisis would offer Eastern bloc countries a conduit for arms to subversive groups throughout the rest of the region.

Participants cautioned that the departure of General Noriega from Panama will not automatically result in the establishment of a democracy and an apolitical PDF. To ensure achievements of these long-term goals, it will be necessary to completely restructure the PDF and its relationship to the civilian government and political parties. Participants recommended that no U.S. assistance be provided until steps are taken to start this process. They also felt that it would be necessary to look at the links between the PDF and affiliated political parties.

Reconstructing Panama will require a coordinated effort between the United States and its allies. Participants cautioned that reconstruction

will be costly and that sufficient money should be allocated for the process. Reconstruction aid would have to be channelled through the Panamanian domestic banking sector to the small business sector. Policies enacted to reconstruct the economy should also encourage Panamanians to bring money back into the economy.

Participants at GAO's Workshop on Panama

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Erik Kjonnerod
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Steve Ropp
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Kim Flowers
Director, Washington Office
Council of the Americas

Juan Belt
Economist, Office of Development, Bureau for Latin America and the
Caribbean
Agency for International Development

Comments From the Department of State and Agency for International Development

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



United States Department of State

Comptroller

Washington, D.C. 20520

May 10, 1989

Dear Mr. Conahan:

I am replying to your letter of April 21, 1989 to the Secretary which forwarded copies of the draft report entitled "Central America: Impact of U.S. Assistance in the 1980s" (code 472160) for review and comment.

The enclosed comments were coordinated within the Department and prepared by the Bureau of Inter-American Affairs.

We appreciate the opportunity to review and comment on the draft report.

Sincerely,

A handwritten signature in cursive script that reads "Roger B. Feldman".

Roger B. Feldman

Enclosure:
As stated.

Mr. Frank C. Conahan
Assistant Comptroller General,
National Security and
International Affairs Division,
U.S. General Accounting Office,
Washington, D.C. 20548

Appendix IV
Comments From the Department of State and
Agency for International Development

GAO DRAFT REPORT COMMENTS
CENTRAL AMERICA: IMPACT OF U. S. ASSISTANCE IN THE 1980's
(CODE 472160)

The Department of State is pleased to have the opportunity to comment on the above-cited report. The Department in Washington and embassies in the region have worked closely with GAO investigative staff in attempting to ensure that the final product is as comprehensive, accurate and useful as possible. The result, however, is mixed.

We have not attempted to provide detailed comments on the report; its scope and the very limited comment period we were furnished preclude this. The following points are more in the nature of general observations on the report as a whole. The Agency for International Development is providing separate comments on the more specific, development-related issues raised in the GAO report.

Central America

Political/Security Objectives

See comment 1.

We regret that our earlier comments were not taken into greater account in preparation of the final report.

See comment 2.

More attention to the U. S. role in seeking a comprehensive regional agreement, to the work of the Special Envoy, and to the fundamental link between democracy and U. S. security objectives would have provided more useful balance. Judgments on the efficacy and content of U. S. policy in support of democracy and development still reflect too little understanding of the role of U. S. diplomacy and of the weight of a sustained, indeed daily, political discourse with the democracies in the region that heavily influenced the positive choices they have repeatedly made.

See comment 3.

The report mentions the Bipartisan Accord between Congress and the Administration without clear acknowledgement of the elements of policy continuity the Accord reflects. Indeed, recommendations made by the report on future policy directions echo the substance of the Accord but without acknowledging their debt to it or the fact that many of these recommendations are already reflected in current policy.

See comment 4.

The GAO observes that the U. S. publicly supported earlier regional diplomacy but that U. S. policy undermined its intent. That assertion raises a fundamental issue latent in the report: the implications that (a) U. S. interests should have been understood to be totally and automatically

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coincidental with those of the participant states in the Contadora process and successive regional discussions, and (b) that U. S. sovereignty in seeking to influence such processes is appropriately limited. Clearly, the evolution of regional peace efforts and of domestic situations in the several Central American states, combined with the course corrections embodied in the Esquipulas process and their subsequent refinement to highlight Nicaraguan compliance deficiencies, shed abundant light on the inadequacies of the processes that the U. S. is alleged to have undermined.

See comment 5.

Overall, the report demonstrates incomplete understanding of the dynamics and politics of regional peace efforts. Astonishingly, it suggests that Nicaraguan failure to meet its commitments is attributable to U. S. support of the Nicaraguan Resistance. At one point, it even implies that the February 1989 El Salvador summit was held in spite of U. S. military assistance to the Nicaraguan Resistance, assistance which had ended one full year before. Nicaraguan efforts to disrupt regional security--central to the raison d'etre of regional peace efforts--is attributed to its "past" military buildup despite the fact that Soviet military deliveries even in 1988 are greater than those of the preceding year. In brief, the report fails to acknowledge that regional peace has been elusive because the Sandinistas have refused to end subversion of their neighbors, repression of their citizens, and their intimidating military buildup.

See comment 6.

The report is correct in asserting that long-range U. S. resource commitments will be required to continue pursuit of such goals. Throughout, however, the report adduces as evidence of policy failure the lack of complete achievement of key policy goals such as broad-based development, consistent respect for human rights, and democracy.

Fairness of judgment would have made clear the necessarily open-ended nature of the effort to pursue those goals, whether in Central America or regions elsewhere that do not suffer from active insurgency or so heavy a historical burden. It is simply unrealistic, for example, to discuss democratic progress in El Salvador as "limited" without introducing a comparative context or even an analysis of El Salvador in its own terms as a transitional system that has made enormous democratic progress and shows promise of capacity to attain mature democracy. The lack of understanding of the relationship between local commitment to democracy and the U. S. supporting role to make progress possible severely undermines the usefulness of the report as a tool for estimating U. S. policy success or failure.

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See comment 7.

The methodology used in recording statements made by those in Central America who spoke to the GAO teams would not hold up against the most fundamental rules of attribution and citation. The paper is replete with "Some observers felt..., while others...." This device denies the reader any information about the individual making the statement or any qualifications or special interests that he/she might possess which would give the reader any indication that this was an informed or unbiased opinion. In this way, the GAO reserves exclusive license to determine whose comments it will use, and whether that person is informed enough to make a credible statement.

Economic Objectives

See comment 8.

The report provides a generally accurate assessment of the short-term success achieved by our ESF grants in promoting economic stabilization. Our efforts to promote structural adjustment, necessary to ensure longer-term growth objectives, are yielding positive results in Costa Rica, Belize and Guatemala; to date, the governments of Honduras and El Salvador have not undertaken similarly extensive adjustment measures.

There are numerous reasons for these differences in results, many of which are set forth in the subject report. In several places, however, the report seems implicitly to criticize "U. S. political objectives" which the GAO believes had overridden attempts to impose and enforce strict economic conditionality. Such references appear on page 65 in connection with our program for El Salvador and on page 66 for Honduras.

Existing legislation recognizes that economic support funds may be needed to support U. S. political goals, in addition to assisting the recipient country to undertake structural reforms necessary to achieve self-sustainable growth. Economic support funds are appropriately used to meet a variety of U. S. national interests usually pursued simultaneously.

Economic reforms are negotiated through a policy dialogue between the U. S. and the recipient country; they are not imposed unilaterally by the United States. As the report itself points out, the rate of economic progress depends most importantly on the willingness of the recipient country to implement reforms.

In Honduras and in El Salvador, there has been progress, but not as yet to the level desired. All the democratic nations of Central America will continue to require an ESF program for

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some time to come. Any premature or overly-rapid reduction of ESF levels to countries in this region will threaten economic and political progress already achieved.

See comment 9.

One additional comment on a factual point. On page 17, the report states that the Central America Initiative proposed a five-year, \$8.4 billion plan of economic assistance to the region, and that Congress appropriated \$6.4 billion. This is incorrect. The \$8.4 billion proposal consisted of \$6.4 billion in funding and \$2 billion in Trade Credit Insurance Program, housing, Commodity Credit Corporation, OPIC, and Eximbank guarantees. Congress did not approve a multi-year appropriation nor did the sum of its yearly appropriations equal \$6.4 billion. Actual funding, though substantial, fell significantly short of both the Central America Initiative levels and of those proposed in the revised Full Funding report presented to the Congress in March 1987.

Panama

See comment 10.

The paragraph on U. S. sanctions against Panama (page 67) should be changed to clarify the timing and substance of U. S. sanctions.

U. S. ESF assistance of \$56 million to Panama was intended to support a mid-1980's stabilization program and was tied to government policy reforms. Uneven progress was occurring when U. S.-Panamanian relations deteriorated in 1987. With the exception of certain humanitarian assistance, all economic and military aid, the sugar quota, and trade benefits were suspended by the Congress and the Administration in 1987-88.

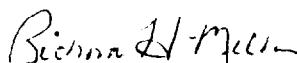
In addition, in 1988, the Administration ordered that Panamanian Government assets in the United States be frozen, payments to the Noriega regime prohibited, and the Canal Treaty payments escrowed. The U. S. economic sanctions contributed to an already bad economic situation. In response to pressures by the Noriega regime on U. S. companies and on the Panamanian employees of U. S. agencies and firms, the United States made certain exemptions to U. S. sanctions so as to permit the U. S. private sector to continue operating in Panama and to avoid certain adverse effects on private citizens.

On another matter, we are confused by the report's language regarding the relationship between the Noriega regime's "fiscal manipulations" and exemptions to the sanctions. The regime did engage in creative schemes and fiscal manipulations in order to continue paying government employees, but these actions were

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separate from any exemptions to U. S. sanctions. While it is true that the exemptions were not intended to benefit the Panamanian regime, it was also recognized that payment of any funds allowed by the sanctions would benefit the regime. Exemptions were authorized nonetheless because of separate and overriding interests in preserving flexibility for U. S. private sector operations in Panama and for humanitarian interests.



Richard H. Melton
Acting Assistant Secretary
Bureau of Inter-American Affairs

The following are GAO's comments to the Department of State's letter dated May 10, 1989.

GAO Comments

1. GAO based its conclusions on analyses of data and the opinions of a wide variety of personnel, including officials from the Department of State in Washington, D.C., and U.S. missions in all five Central American countries and in Panama and Belize. We believe we have appropriately considered the Department's comments and incorporated them where the evidence bore out its assertions.

2. Our objective was not to examine the daily processes used to carry out U.S. foreign policy, but rather to review the effectiveness and impact of programs and other activities. Nevertheless, we believe we have adequately discussed the role of diplomacy, including bilateral talks between the United States and all countries in the region, the work of the Special Envoy and the Secretary of State, and the visit of the Vice President to El Salvador in 1983. Further, our conclusions and matters for consideration stress the need for dialogue among the United States and Central American countries.

3. We agree with State that the Bipartisan Accord still continues to embody previous objectives, namely, support for democracy and regional security. However, the Accord significantly altered the approach to achieving these objectives by adopting a bipartisan approach with primary emphasis on achieving regional stability through a regional political settlement.

We recognize that our report's recommendations parallel the substance of the March 1989 Accord. GAO working papers with our recommendations were circulated to the Department of State in November 1988 and January 1989. In addition, State Department officials attended both our Symposium on Central America in January 1989 and Workshop on Panama in February 1989, where the tentative recommendations were discussed.

4. We found that the United States publicly endorsed Central American interests as its own, but then, in some instances, acted contrary to these stated objectives. Further, we agree with the Department of State that the Central American countries continually improved upon their regional peace efforts but do not agree with the Department's implication that the absence of peace can be attributed to the inadequacies of

the agreement separate from any actions by the United States. The current situation reflects many factors and actions by a wide variety of U.S. and Central American actors.

5. We do not agree with the Department's interpretation and characterization of our report. We do not state that the Nicaraguan failure to meet its commitments is attributable to U.S. support of the contras. We do state that U.S. support for the contras gave the Sandinista government the pretext not to adhere to its earlier promises to democratize and that disbanding the contras as a fighting force will deny them this pretext in the future. We have modified the statement on the 1989 El Salvador summit to indicate that the summit was held despite incomplete compliance by a number of countries to the plan's provisions. We have included reference to the Departments of State and Defense concerns about Nicaraguan support for insurgencies. Overall, we agree that Nicaragua has contributed to regional instability, but we also believe that social, political, and economic injustices in the region have been the root cause of discontent and insurgencies. For example, U.S. embassy officials in El Salvador agree that even if Nicaragua were to democratize, the insurgency in El Salvador would continue.

6. We agree with the Department that, in fairness, U.S. efforts in Central America should be viewed as open-ended and evaluated accordingly. We assessed U.S. activities on the only criteria set by the administration, in consultation with the Congress, and then pointed out that unrealistic time frames had been established and that extended periods of time will be needed to achieve these goals. We note that while steps taken to strengthen Salvadoran democracy may appear small in the short term, over the long term their impact could be quite significant. Finally, we believe that State's assertion that the report lacks understanding of the relationship between local commitment to democracy and the U.S. supporting role is inaccurate. We clearly state that, for democracy to succeed, the Central American countries must commit themselves to democracy.

7. We have modified attributions and citations in all the chapters to provide more information about individuals making the statements whenever possible. It is not GAO policy to identify by name persons we have interviewed. We would like to point out, however, that the individuals and groups we quote represent a broad spectrum of occupations, affiliations, and points of view. Each, by experience or education, is qualified to address the respective issue. We feel that excluding such views from

our report would mislead the reader and result in unrepresentative conclusions.

8. We are aware of the legislation governing the use of ESF and have previously reported on it (Political and Economic factors Influencing Economic Support Fund Programs, GAO/ID-83-43, Apr. 18, 1983, and the reports cited in footnotes in Ch. 4). We agree that ESF has both economic and political objectives and did not intend to imply that one objective is better than the other. Our intent was to demonstrate that these two objectives will continue to compete as long as there is political instability in the region and that economic objectives will probably continue to suffer.

9. We have revised the report to indicate that \$2 billion of the administration's original \$8.4 billion proposal consisted of guarantees. This data was provided in our introductory chapter for information purposes. Our analysis was based on actual military and economic assistance to the region, estimated at \$6.5 billion for the 1981-88 period.

10. We have revised the report to account for the Department's suggested changes to clarify our discussion on Panama.

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AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON, D.C. 20523

Mr. Frank C. Conahan
Assistant Comptroller General
National Security and International
Affairs Division
General Accounting Office

Dear Mr. Conahan:

This is in response to your April 21, 1989 letter to Administrator Woods and the accompanying GAO Draft Report, "Central America: Impact of U.S. Assistance in the 1980s." Our comments are limited to those sections of the draft report dealing with matters relating to A.I.D. and A.I.D.-managed activities.

In general, we are pleased to see recognition that the overall development strategy being pursued by the Agency for International Development (A.I.D.) in Central America is fundamentally sound. The draft report recognizes the need for A.I.D. involvement with policy reforms to achieve rapid and sustained growth as well as the need to carry out programs which impact directly on poor people. Specific comments follow.

Regarding Guatemala, the draft report refers in both the Executive Summary (p.11) and Chapter 4 (p.69) to the need to encourage, and even condition assistance on, Guatemala's privatizing "inefficient state-owned companies." A.I.D. is supporting privatization efforts in Guatemala and elsewhere. However, Guatemala in fact has a relatively small number of state enterprises when compared to other less-developed countries around the world. Only three state-owned enterprises are cited as problems in the draft report. One of them, the merchant marine, was recently closed; another, the national airline, is being proposed for partial divestiture. While we agree that the third, the telephone company, suffers from inefficient management and obsolescent equipment, we believe it is a less likely candidate for privatization. New investment and management reform are more probable solutions.

But the central point is that inefficient state-owned enterprises are a relatively less serious problem in Guatemala and not significant enough to merit the conclusion. Furthermore, it tends to detract from the more serious development concerns in Guatemala cited elsewhere in the draft

See comment 1.

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report, namely the need to use U.S. resources and influence to encourage Guatemalan government policies to invest more in bringing the benefits of growth to its most disadvantaged citizens in the Highlands. We would suggest that the references, especially to conditioning aid on privatization, be revised or dropped from the final report.

See comment 2.

With respect to Honduras, we think that the characterization in the Executive Summary (p.8) is not balanced. On page 67, the draft report notes that Honduras has recently (in the last couple of years)... "been more amenable to reforms being suggested by the United States." This point should be included in the Executive Summary. Also, you may want to add the fact (not mentioned anywhere) that Honduras' growth rate averaged a solid 3.5 percent per year over the last four years either in the body of the report or in the Executive Summary. However, I would note that we accept the general tenor of the draft report's comments on Honduras' policy reform progress, and we are seeking both a higher level and faster pace of reform in the future in Honduras.

See comment 3.

On page 33, it is suggested that we need to "enforce or implement stricter financial controls over direct U.S. assistance..." in El Salvador. A few years ago this thought may have had validity, but not now. Very strict controls and thorough audit processes have been put in place. In FY 1989, for example, 114 audits are scheduled to be conducted by A.I.D.'s Inspector General, non-federal audit firms, and host country organizations with U.S. technical assistance. This wording should be dropped from the report.

See comment 4.

The draft report makes references (p.62) to Costa Rica's debt burden being a serious threat to its future economic growth. We agree but would note for the draft report that the Costa Ricans are aggressively pursuing a debt buyback plan which we think has merit and could be a good trial model for Secretary of Treasury Brady's debt reduction plan. Also, our information indicates that Costa Rica's commercial debt is presently about \$1.6 billion, not \$2.6 billion as stated on page 62.

See comment 5.

In Chapter 5 (p.87), the draft report suggests a need to increase intra-regional trade, "possibly by recreating a regional economic community similar to the Central American Common Market...." (CACM). As your staff is aware, there is considerable interest in Central America in a rebirth of the CACM. However, if this route is taken with a view to preserving a highly protected regional market and without addressing the CACM's major structural deficiencies such as exchange rate distortions among the five countries, this approach would be counterproductive. We suggest that you

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either drop this suggestion or add language indicating that it is more important that Central America orient itself to participate competitively in world export markets offering greater potential for growth and that serious country-specific structural problems should be addressed as a precondition to reactivating the CACM.

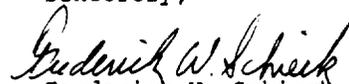
See comment 6.

The statement (p. 78) that inflows from other sources have not materialized is incorrect. While flows from other donors are only now beginning to materialize, private capital flows have been substantial. Our figures, using primarily IMF data, show a net inflow of private capital exceeding \$1 billion during 1984-88, compared to a net outflow on the same basis of \$1.2 billion during 1980-83.

See comment 7.

There is one other comment which I would like to add to this abbreviated response to the draft report. It has to do with Nicaragua. The draft report makes several references to the deterioration of that country's economy due to governmental mismanagement, war, and economic sanctions. There is no reference to the massive Soviet bloc economic aid (from 1982-88, \$2.9 billion, \$550 million in 1988 alone) pouring into Nicaragua in the 1980's. The addition of data on these flows, which exceed U.S. flows to any country in the region, would be most useful as a base for comparing the effectiveness of U.S. aid to Central American during the 1980's. Without this information, there is a major gap in the draft report.

Sincerely,



Frederick W. Schieck
Acting Assistant Administrator
Bureau for Latin America
and the Caribbean

The following are GAO's comments to the Agency for International Development's letter dated May 4, 1989.

GAO Comments

1. We agree with AID that Guatemala has serious developmental concerns and that U.S. efforts should encourage the government of Guatemala to invest more in bringing the benefits of growth to its most disadvantaged. Further, while we recognize that Guatemala has fewer state-owned enterprises than other developing countries, we still believe that they are a problem. Specifically, while performing fieldwork in Guatemala, U.S. and other donor officials, some Guatemalan government officials, and representatives of the private sector consistently complained about poor functioning of the state-owned telephone system and its negative impact on economic growth and private-sector investments. Nevertheless, to recognize AID's concern that inefficient state-owned enterprises are a less serious problem than development concerns, we have removed references to conditioning U.S. assistance on privatization.
2. We have added AID's suggested change to our Executive Summary to make our characterization of the Honduran government's reform efforts in the Summary parallel that in the report text. We believe that citing such a growth rate is misleading, since it masks severe economic problems and is attributable, in part, to the high levels of U.S. assistance and the Honduran government's failure to service its foreign debt.
3. We agree with AID and have dropped the wording from the report.
4. AID is incorrect in stating that Costa Rica's commercial debt is \$1.6 billion rather than the \$2.6 billion that we cite. Costa Rica's commercial debt amounts to \$2.597 billion, of which \$290 million is private nonguaranteed debt, \$676 million is short-term debt (to include the accumulation of interest arrearages), and \$1.6 billion is debt to private suppliers and financial markets (figures are rounded), according to the World Bank.
5. Rather than drop the suggestion, which has potential for contributing to economic growth in the region, GAO has added language as suggested by AID.
6. We reviewed the agency's support for this comment and added information to give a more complete analysis of the situation.

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7. We have added information on the estimated levels of Soviet bloc economic aid to Nicaragua.

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